

BEFORE THE INSURANCE COMMISSIONER
OF THE STATE OF WASHINGTON

In the Matter of the Application)
regarding the Conversion and)
Acquisition of Control of)
Premera Blue Cross and its)
Affiliates) Docket No. G02-45
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)
)
)

Adjudicative Hearing

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Day 9

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Tumwater, Washington

Taken Before:

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P R O C E E D I N G S

9:00 a.m.

JUDGE FINKLE: Ready to proceed if you are.

MR. HAMJE: We are. The OIC Staff calls
Dr. Ed Gold to the stand.

EDWARD A. GOLD, having been first duly sworn by the
Judge, testified as follows:

DIRECT EXAMINATION

BY MR. HAMJE:

Q Dr. Gold, would you please state your full name.

A Edward Allen Gold.

Q Please state your position and business address.

A I'm a director in PricewaterhouseCoopers advisory practice,
1900 K Street Northwest, Washington D.C.

Q Can you give us a description of what the advisory practice
does at PricewaterhouseCoopers?

A Yes. We provide financial and economic advice to clients who
are involved in complex business problems and disputes.

Q Please describe your educational background.

A I have a bachelor's degree in economics from University of
Michigan and a master's and Ph.D. from the University of
Rochester, also in economics.

1 Q Please describe your experience that is relevant to PwC's
2 engagement in this matter.

3 A Well, for the last 10 years, most of the projects I've worked
4 on has involved analyzing competition and the methods that
5 firms use to increase profits. Some of those projects have
6 involved antitrust matters such as monopolization or mergers.
7 Other projects that were not antitrust still involved market
8 power and the ability to use market power to try to raise
9 prices. Many times I've been asked to look at financial and
10 economic data and make determinations about the impact of
11 business decisions with respect to that data.

12 Q What was PwC asked to do that resulted in your involvement in
13 this matter?

14 A PwC economic team, the team working on the economic impact
15 report, looked at the characteristics of the market and the
16 manner in which health insurance is purchased. My role was
17 to assist in evaluating the potential profitability of
18 certain commercial insurances, insurance lines of business,
19 of Premera and the potential differences that may exist
20 across the different lines of business and geographies.

21 Q What did you do?

22 A I estimated the extent to which Premera's premiums and
23 healthcare costs would need to change in order to achieve
24 certain target margins in each of the different lines of
25 business.

1 Q In connection with PwC's engagement, did you participate in
2 the preparation of one or more reports?

3 A Yes, I did.

4 Q Were you involved in the preparation of the report that's
5 been admitted here as Exhibit S-20 entitled "Economic Impact
6 Analysis of the Proposed Conversion of Premera Blue Cross for
7 the State of Washington" dated October 27, 2003?

8 A Yes, I did.

9 Q Have you also submitted pre-filed testimony in this matter?

10 A Yes.

11 Q Does that include both direct and responsive testimony?

12 A Yes.

13 Q Do you adopt your pre-filed testimony and those portions of
14 the report for which you were responsible?

15 A Yes, I do.

16 MR. HAMJE: At this time, the OIC Staff offers
17 Exhibit S-25, which is Dr. Gold's curriculum vitae, S-45,
18 which is his pre-filed direct testimony, and S-46, which is
19 his pre-filed responsive testimony.

20 MR. KELLY: No objection.

21 MS. HAMBURGER: No objection.

22 JUDGE FINKLE: Admitted.

23 Q (BY MR. HAMJE) Dr. Gold, would you please summarize your
24 opinions.

25 A Yes. I have four. Premium increases of eight to ten percent

1 for the individual line of business in 16 counties in Eastern
2 Washington are needed for Premera to achieve target margins
3 in 2007.

4 Premium increases of two to four percent in the
5 regulated small line of business are needed in 18 counties in
6 Eastern Washington in order for Premera to achieve target
7 margins in that line of business in 2007.

8 The third opinion is that it is reasonable to assume
9 that premiums in those 16 and 18 counties in Eastern
10 Washington in the individual and regulated small lines of
11 business could rise by at least a few percentage points.

12 And at this point let me just point out the reason I'm
13 focusing on prices and not costs are because Dr. Leffler's
14 and Dr. McCarthy's analyses both lead to essentially the same
15 conclusion with respect to future decreases in reimbursement
16 rates. Dr. McCarthy's testified that there is no market
17 power; therefore, reimbursement rates cannot decrease. While
18 Dr. Leffler testified that there was market power on the
19 buying side but that it had been largely exploited, also
20 suggesting that there aren't many opportunities for
21 decreasing reimbursements rates in the future. So I focused
22 on prices.

23 My fourth opinion is that the market shares for the
24 sale of insurance that were put forward by Dr. Leffler are
25 more reasonable than the market shares for the sale of

1 insurance that Dr. McCarthy put forward.

2 Q In connection with your engagement, did you make any
3 assumptions?

4 A Yes. Based upon the research and work that the rest of the
5 economic impact team for PwC did plus Dr. Leffler's work and
6 discussions with them, I set out four assumptions which -
7 which are important for my first two opinions.

8 The first assumption is that Premera's financial
9 projections represent a good baseline.

10 Second is that the conversion to for-profit from
11 not-for-profit will increase the pressure for Premera to
12 achieve target margins.

13 Third, Premera has market power in the counties and
14 lines of business in which it has at least 65 percent market
15 share.

16 And fourth, that regulatory requirements would not
17 prevent premiums from being raised.

18 Q How did your assumptions influence your analysis?

19 A Basically I had to select the right set of - the right
20 parameters to analyze. I'm trying to estimate an increase in
21 the operating margins, and that's being driven by an increase
22 in prices. We know that as prices go up, individuals are
23 likely to switch out of purchasing insurance from Premera.
24 But the assumption of market power predicates choosing an
25 elasticity that's consistent with that assumption. So

1 elasticity represents the amount, the responsiveness of
2 customers, to price increases. The greater the elasticity,
3 the greater the responsiveness. If there is market power,
4 there must be a relatively low elasticity. So I chose an
5 elasticity that was consistent with that assumption.

6 That fed into the calculations that I made of how much
7 the operating margins would be when I looked to see how to
8 get the individual and small lines of business to achieve the
9 target margins.

10 Q Can you briefly explain to us how you did the analysis?

11 A Yes. I have a couple of slides which show the maps of the
12 state of Washington which come out of our economic impact
13 report. They are - that's the Exhibit S-20 from page 93 and
14 94.

15 Basically my first step was using Dr. Leffler's
16 analysis of market share, I identified the counties that had
17 at least 65 percent market share in the individual line of
18 business or the small line of business. And then the
19 individual line, I identified 16 counties, which includes the
20 14 in which Premera has the exclusive rights to the Blue
21 trademarks, plus Garfield and Asotin.

22 If we go to the next slide, in the regulated small
23 group, I identified 18 counties, again the 14 in which
24 Premera has the exclusive rights to the Blue mark, plus
25 Garfield, Asotin, Yakima and Klickitat.

1 Then using Premera's financial projections, I computed
2 baseline premiums, revenues, costs, member months and
3 operating margins for all of the counties. I then adjusted
4 the premiums up in the two sets of eastern counties so that
5 the margins in those counties were high enough to allow the
6 overall statewide margins for each line of business to
7 achieve the target margins. I then could compare the
8 premiums from the adjusted counties to the premiums that
9 existed in the baseline for those same set of counties to
10 figure out what the percentage increase in those premiums was
11 that was required to achieve those target margins.

12 Q Just for the record, I would like to point out that on the
13 two slides, the exhibit number that's listed is incorrect.
14 It's Exhibit S-20, not 120.

15 A My mistake.

16 Q How did you develop your opinion regarding where it was
17 reasonable to assume where Premera could increase prices?

18 A I looked at a number of factors, which have all been
19 testified to by different people in this proceeding. The
20 first is that developing a network takes time and resources.
21 In the alternative, you can rent a network. But renting a
22 network inserts a middleman, which presumably adds some costs
23 that might create a cost disadvantage for the competitors.
24 In addition, Dr. Leffler has talked about the fact that
25 renting a network involves higher reimbursement rates, which

1 also would lead to a cost disadvantage, and Dr. Leffler's
2 talked about the use of market power to lower reimbursement
3 rates by Premera, which would add to yet another cost
4 disadvantage. If Premera's cost advantages relative to their
5 competitors are passed on, then Premera's prices would be
6 lower and it would suggest the possibility of raising prices.

7 Another factor I looked at is that some of Premera's
8 executives, through their pre-filed testimony, have spoken
9 about the significant amount of capital that was needed to
10 fund significant increases in membership and the fact that
11 not-for-profit firms might be restricted in their ability to
12 raise those funds. Some of Premera's competitors are also
13 not for profits and may face similar restrictions.

14 Another factor is that Premera's Blue Cross and Blue
15 Shield marks do convey value and information to its
16 competitors and create a difference in the areas where they
17 have the exclusive rights to those marks.

18 Dr. Leffler and Ms. Hunt have looked into switching
19 costs and have concluded that there are nontrivial switching
20 costs which create at least a need for a five percent
21 difference in prices before employers are willing to consider
22 a switch. In addition, small firms and individuals cannot
23 easily self-insure. And finally, Premera, in the individual
24 line of business, has been adding enrollees to that line of
25 business by the thousands over the - each of the last two

1 years, whereas Asuris has a total enrollment in the
2 individual line of business in the 16 counties that I
3 identified of only a lit bit over a hundred people total, and
4 they have been - they had individuals in that line of
5 business since as far back as at least 2001.

6 Q Now, Dr. Gold, if you could describe your reasoning behind
7 your opinion that Dr. Leffler's market shares are more
8 reasonable. Well, let me ask you this instead. Before we go
9 on to that question, I don't think you discussed what these
10 factors led you to conclude. Can you - can you describe what
11 they led you to conclude.

12 A Yes. Thank you. Starting with the large market and the
13 west, most of these factors do not hold or do not create any
14 difference between Premera and its competitors. So that
15 tells me that there's very little likelihood that there'd be
16 an increase in prices beyond the competitive levels for those
17 two areas. However, for the individual market, all of the
18 factors hold. Now, my analysis concluded that Premera needed
19 an eight to ten percent increase in prices to achieve the
20 target margins.

21 Do I know if they can actually raise prices that far?
22 No, actually I do not. But it does seem reasonable to assume
23 that they can raise them at least by a few percentage points.
24 And if they cannot, it goes back to this question of there
25 being some tension between trying to achieve target margins,

1 increasing membership, and achieving essentially their
2 overall goals.

3 In the small line of business, all of the factors
4 except for the last one that I mentioned hold. And the fact
5 that the last one doesn't hold makes the picture a little
6 less clear.

7 Dr. McCarthy has given some evidence showing that
8 Asuris's membership in the small line of business have
9 increased a lot in the last two years. But until we put that
10 into context, we really don't know what that means. So first
11 of all, my analysis in that line of business indicates that
12 they only need a two to four percent increase in prices to
13 achieve the target margins. So it's a much smaller hurdle
14 that they need to achieve.

15 But Asuris in 2002 increased enrollment by a little
16 over 10,000 people in the small line of business in the east
17 in those 14 counties. In 2003, they only added 2500. And
18 why is that growth slowing down? You know. Is Asuris
19 topping out? But we actually have to go - probe even
20 further. Is Asuris underpricing relative to Premera? If
21 they are underpricing significantly relative to Premera, then
22 we have to answer the question of whether or not that - that
23 lower price is sustainable. And furthermore, we really need
24 to understand how big is the price gap between Premera and
25 Asuris before we can put into context whether or not the

1 number of people that Premera - that have switched from
2 Premera to Asuris is big enough to say that there was no
3 market power.

4 Finally, as Dr. McCarthy has testified, that his
5 analysis showed that the prices, in fact, were equal across
6 Premera and Asuris. Now, his analysis was not done on a
7 line-of-business-by-line-of-business basis. But assuming
8 that the prices were the same across the two lines of
9 business - across the two companies for that line of
10 business, then why are these people switching? It's possible
11 that there are a set of individuals who have switched because
12 they were dissatisfied with Premera's service, leaving a set
13 of loyal customers behind at Premera. Basically until those
14 questions are answered - and I don't know the answers to
15 those questions - but until those questions are answered, we
16 can't definitively say that the increase in membership from
17 Asuris in that particular line of business means that we know
18 they can't raise prices.

19 Q Now I'd like you to turn to your last opinion that you
20 mentioned earlier in your testimony. And can you describe
21 your reasoning about that opinion that Dr. Leffler's market
22 shares are more reasonable.

23 A Yes. Even if you assume - even if you accept Dr. McCarthy's
24 market definition that all lines of business should be
25 included and all counties in the state should be included, I

1 still do not accept his methodology for calculating market
2 share. Essentially it assumed that the more successful you
3 are in the market from where you're coming, the more
4 successful you will be in the market into which you're going
5 to enter.

6 And if I can give you an analogy outside of healthcare,
7 Boeing we know makes very large jet airplanes. To the best
8 of my knowledge, they do not make one-seat or two-seat
9 airplanes. If they decided they wanted to enter the
10 one-seat/two-seat airplane market, presumably they'd be able
11 to. But their market share in the commercial jetliner market
12 may have no relevance at all to the market share that they
13 could achieve in the one-person/two-seater airplane market.
14 Another way of thinking about it is that the methodology does
15 not take into account the characteristics of the firms that
16 sell health insurance and how - and what makes them different
17 from each other.

18 And there are a number of examples of this. Molina
19 specializes in Medicaid. If they were to enter the
20 individual or small line of business on the commercial side,
21 there's no particular reason to believe that their success in
22 the area that they specialize in should be reflective of the
23 success that they will have in individual or small. Kaiser,
24 for example, operating in Clark County undoubtedly has had
25 its market share in Clark County positively impacted by its

1 proximity to Portland. There is no such proximity if they
2 were to enter in the east. And Regence is another example we
3 know has access to a Blue Cross or Blue Shield mark in the
4 west but does not have access to that same mark in 14
5 counties in the east.

6 So these differences create - well, the differences in
7 the characteristics create reasons why you would not think
8 that the market share from where you're coming necessarily
9 implies market share into where you might be entering.

10 Q Dr. Gold, does that conclude your testimony here this
11 morning?

12 A Yes, it does.

13 MR. HAMJE: That's all the questions we have at
14 this time.

15 MR. KELLY: Good morning, Dr. Gold.

16 THE WITNESS: Good morning.

17 MR. HAMJE: I have a couple of areas to question
18 you about. Might be a little bit longer than 15 minutes
19 since I think you raised a number of Blue matters this
20 morning.

21
22 CROSS-EXAMINATION

23
24 BY MR. KELLY:

25 Q Let's start with an introduction about your background.

1 First of all, you're not an actuary; is that correct?

2 A That's correct.

3 Q Your Ph.D. was on gender discrimination; is that correct?

4 A No. My Ph.D. is in economics.

5 Q Okay. What was the topic of your Ph.D.?

6 A Topic of my dissertation?

7 Q I'm sorry. Dissertation.

8 A The topic of my dissertation was gender discrimination. Some
9 of the areas actually had to do with where doctors are
10 placed.

11 Q And you do not have any papers on healthcare you've written;
12 is that correct?

13 A I have not written any papers on healthcare.

14 Q And while you've been used as an expert before, you've never
15 been used as a healthcare expert before; is that correct?

16 A That's correct.

17 Q And you've never qualified in court as an antitrust expert;
18 is that correct?

19 A That is correct too.

20 Q And your original assignment here was as an econometrician,
21 is that correct, to build and defend a model?

22 A Well, first of all, an econometrician would be a wrong
23 description because it's not an economy metrics model. It's
24 an economic model.

25 Q Okay. I stand corrected. Your original assignment here,

1 what was produced in the first report, the economic impact
2 analysis, was an economic model; isn't that correct?

3 A My original assignment was to try to look at the operating
4 margins and whether or not they could rise to achieve those
5 operating margins. And I responded to other people who have
6 talked about that analysis.

7 Q Right. And actually you wrote chapter 9 I think of your
8 first report; isn't that correct?

9 A All you but the last page anyway.

10 Q Right. And that chapter is dealing exclusively with your
11 economic model; is that true?

12 A That's true.

13 Q And it was not until you filed your responsive testimony
14 dated April 14th, 2004, that you began to talk about your
15 views about Dr. Leffler versus Dr. McCarthy; isn't that true?

16 A Well, you know, I couldn't talk about Dr. McCarthy until I
17 saw his report.

18 Q Right. And you had seen his report certainly by the time
19 that I deposed you, had you not?

20 A As we discussed in the deposition, a few days before you
21 deposed me, yes.

22 Q Your assignment at that time was to do the model and then you
23 came up with your analysis of Dr. Leffler and Dr. McCarthy,
24 and you wrote it down in April of 2004; isn't that true?

25 A I believe that was the first opportunity that I had to tell

1 you what I reviewed from Dr. McCarthy's work and what I saw
2 from all of Dr. McCarthy's papers.

3 Q And of course, you had been working together with
4 Dr. Leffler, sharing drafts and so forth, long before I
5 deposed you; isn't that true?

6 A We shared a draft.

7 Q Okay. So you certainly had plenty of opportunity, if it had
8 been your assignment to try to bolster Dr. Leffler's
9 viewpoints, to have done so prior to your being deposed back
10 in November; isn't that true?

11 A As I said, at that point, I hadn't understood what
12 Dr. McCarthy was going to do, so there was no reason to
13 bolster Dr. Leffler's analysis.

14 Q Well, you didn't do anything in regard to looking at and
15 seeing whether you were going to . . . You didn't have any
16 assignment to prepare testimony or a report to support
17 Dr. Leffler as of the time that I deposed you in November of
18 2003; isn't that true? Yes or no?

19 A I don't know that I had a specific assignment to do that.

20 Q Okay. Now, the industries that you have worked in over the
21 years are medical devices, undersea fiber-optic cable, active
22 matrix display and the forest industry; is that correct?

23 A With respect to some of the monopolization questions are you
24 asking me? Or all industries that I've ever worked on?

25 Q I asked you I believe what are the industries that you've

1 worked in, and you gave me that list, didn't you?

2 A I think we were talking in the context of antitrust cases at
3 that time.

4 Q So and you also worked in the healthcare area of
5 pharmaceuticals, isn't that true, pharmaceutical devices?

6 A Yes. Yes. That's true.

7 Q And you indicated in your deposition back in November that
8 Dr. Leffler was assessing market power, not you; isn't that
9 correct?

10 A That's true.

11 Q And you indicated in your deposition that you are not opining
12 on whether Eastern Washington is a relevant geographic
13 market, isn't that true?

14 A That is true.

15 Q Now, I'd like to turn for a minute to the discussion you had
16 about factors. Do you recall that a few minutes ago?

17 A Yes.

18 Q Now, these are known as barriers to entry, aren't they?

19 A Yes.

20 Q Okay. And these were proposed to you by Ms. Hunt, were they
21 not?

22 A No. Actually they, as barriers to entry, were not.

23 Q Now, you talked first of all about the fact that you would
24 have to develop a network, isn't that true, as a potential
25 factor of barrier to entry?

1 A Yes.

2 Q Let me just see if I understand this. The context of all of
3 this, of course, is not about expanding in Eastern Washington
4 by competitors today, because you agree with Dr. Leffler and
5 Dr. McCarthy that Premera's prices are not what you
6 economists call supercompetitive; is that correct?

7 A No. I'm not sure that I have that opinion on . . . I don't
8 think actually I have an opinion on where exactly Premera's
9 prices are relative to their competitors.

10 Q Okay. Okay.

11 A I've seen what the other two experts have . . .

12 Q And they also say that they're not supercompetitive; is that
13 correct?

14 A For different reasons.

15 Q Okay. Same conclusion though; right?

16 A In the case of one of them, it has to do with the regulatory
17 and procedural restraints.

18 Q But the issue that the Commissioner needs to grapple with is
19 if you assume - what would happen if Premera tried to create
20 what's called supercompetitive prices, in other words, tried
21 to substantially raise their prices. Isn't that really the
22 issue that the Commissioner needs to look at?

23 A I'm not sure exactly what issue the Commissioner needs to
24 look at.

25 Q Let me rephrase it. We want to look at - the Commissioner

1 may also want to look at - what could happen in Eastern
2 Washington, we need to do it in the context of, well, suppose
3 Premera were to raise its prices. What would the response of
4 competitors be? Isn't that true?

5 A As I said, there's tension - there's a number of things to
6 look at: How much they're going to make and whether or not
7 prices could go up and how much they might go up. All of
8 those things come into play.

9 Q I understand. Let me ask you this: Can you focus with me on
10 the question of if Premera were to try to raise its prices,
11 then we would want to know what the responses of competitors
12 would be?

13 A Yes.

14 Q Can we focus on that?

15 A Yes.

16 Q Okay. So you say well, first of all there's a cost to
17 developing a network. Now, for those competitors who are
18 already in Eastern Washington, that isn't a cost for them
19 because they already have a network. Isn't that true?

20 A Assuming those networks are equally good.

21 Q But when Premera goes in and tries to raise prices, then they
22 would have a network and they could easily expand to meet the
23 areas where Premera's - customers where Premera's raising
24 prices and it wouldn't be a barrier, the network; is that
25 correct?

1 A That would be correct I think with respect to that particular
2 factor and the people who were already there. Yes.

3 Q All right. Now, other competitors who can see, wow,
4 Premera's raising prices; we can beat that; would be
5 confronted, if they didn't have a network, with what to do
6 and they would have to - they could rent a network; is that
7 correct?

8 A Yes.

9 Q And you say, well, wait a minute, there's a little bit of an
10 additional cost to renting a network; isn't that true?

11 A That's at least a factor to consider.

12 Q But here the Premera raises its prices - I don't know - \$3.
13 It costs a dollar to rent a network. The competitor can come
14 in and raise its prices \$2 and still beat Premera and make a
15 profit; isn't that true?

16 A I'm not sure I'm following your math there.

17 Q Premera raise its prices \$3.

18 A You really need to know where the starting point is, first of
19 all.

20 Q Well, do you see the point that - the point that I'm asking
21 you about? Isn't it possible that if Premera is raising its
22 prices, a competitor could come in, rent a network, perhaps
23 have to pay a little bit of a premium for renting the
24 network, and still be able to have a profitable product that
25 would be lower than Premera's price?

1 A No, I don't see that. In all else equal, they would have
2 higher costs.

3 Q But the point is that Premera has raised its prices
4 supercompetitively, much higher than it - than it's
5 currently --

6 A Well, they could certainly raise their prices to the long-run
7 average costs of their competitors.

8 Q Aren't they going to . . . Excuse me. Have you done a study
9 to see what the actual cost or amount of a barrier of any -
10 renting a network would be in terms of the situation of
11 Premera substantially raising its prices?

12 A I've only seen what Dr. Leffler has done.

13 Q So you haven't contributed to any of that?

14 A No.

15 Q Now you talked about capital needs for funding and you said,
16 well, that would make it difficult, in your view, for
17 nonprofits to enter Eastern Washington; is that correct?

18 A It might.

19 Q It might. Okay. And of course, that particular barrier or
20 factor wouldn't apply to for-profits, would it?

21 A That's another reason why on the large, I don't think that
22 prices would go up.

23 Q No. If you would please respond to my question. The problem
24 of a lack of capital that a nonprofit might face would not
25 apply to a company that is for-profit; isn't that true?

1 A Yes. That's true.

2 Q Thank you. And you have done no study in any effect as to
3 what impact, if any, capital needs for nonprofits would be,
4 as to whether they would constitute a barrier to those firms
5 entering in Eastern Washington if Premera drastically raises
6 its prices, have you?

7 A No, I have not.

8 Q Okay. Now, your next barrier that you raised as a
9 possibility was the Blue mark; is that correct?

10 A That's correct.

11 Q First of all, did you hear Ms. Donigan's testimony last week?

12 A No, I did not.

13 Q Did anyone tell you about the observations she made about the
14 situation Premera had, even with its Blue mark, in dealing
15 with a bid in her Washington Mutual?

16 A No.

17 Q So the mere fact that you have a Blue mark doesn't mean
18 you're going to get business, does it?

19 A I don't know. I didn't hear that observation.

20 Q Okay. Asuris is a company that is in Eastern Washington and
21 does not have a Blue mark, isn't that true?

22 A That is true.

23 Q So let me ask you this question: Have you done any study
24 yourself to determine whether the presence or absence of a
25 Blue mark is a barrier to expansion in Western Washington if

1 Premera raises its prices?

2 A As we discussed, my job was not to try to identify where
3 there was market power. So I was just looking at whether or
4 not it was reasonable to make some assumptions.

5 Q I understand that. But your job today is to, with all due
6 respect, answer my questions. And my question was: Have you
7 done a study to see whether the presence or absence of a Blue
8 mark would constitute a barrier to entry if Premera raised
9 its prices? Yes or no?

10 A I considered what others have been testified to. I did not
11 personally do a study.

12 Q Okay. And then you talked about nontrivial switching costs,
13 did you not, as a potential barrier?

14 A That is correct.

15 Q And I guess we already know that you didn't hear
16 Ms. Donigan's testimony about the sensitivity that she finds
17 of small business owners to any increase in prices, did you?

18 A No, I did not.

19 Q And in any event, you did not do a study to determine whether
20 switching costs would have - constitute a barrier to change
21 in Eastern Washington if Premera raises its prices, did you?

22 A Again, I considered the testimony of others, but I did not do
23 my own personal study.

24 Q Would you please answer that question yes or no.

25 A No.

1 Q Thank you. And then . . . Well, let's do a wrap-up question
2 here. For any of these factors, did you do any study to
3 determine whether they would, in fact, constitute a barrier
4 to entry if Premera raises its prices?

5 A No, I did not.

6 Q And you next said that - you said it seems reasonable that
7 Premera might be able to raise its prices by a few percentage
8 points. You did not do any analytical study to ascertain
9 whether Premera could, in fact, raise its prices by any
10 percentage, did you?

11 A Well, that's not exactly what I said. I made some
12 assumptions to predicate my analysis, and then I assessed
13 whether or not that is - some of those assumptions were
14 reasonable.

15 Q Okay. I understand that. My question is: Did you do an
16 analytical study to determine whether, in fact, what you
17 think might occur, there's any factual basis that it would
18 occur?

19 A No, I did not do a study to determine whether or not they
20 would occur.

21 Q And in your model, just to switch to that for a minute, in
22 terms of . . . You never - your model only looks at, well,
23 how much would you have to increase premiums in order to
24 achieve a target margin; isn't that correct?

25 A That's correct.

1 Q Okay. You did not take into account any reduction in
2 administrative costs by Premera to achieve target margins,
3 did you?

4 A I used the initial projections that they provided in their
5 Form A filings. I understand that updated budgetary
6 projections of theirs might have concluded that, but I did
7 not take those into account because our economic impact team
8 I think addressed those.

9 Q Now, then you talked about the growth of Asuris. And you
10 said, well, looking at one year, you noticed there was a
11 reduction in the rate of growth; is that correct?

12 A That's correct.

13 Q Now, first of all, the fact of a reduction one year in the
14 rate of growth really doesn't tell us anything whatsoever
15 about what would happen if Premera increased its prices as to
16 whether Asuris would be able to take business away from
17 Premera in that context, does it?

18 A Out of context, that information doesn't tell us anything
19 really; doesn't tell us whether they can or cannot.

20 Q Okay. So your discussion about the reduction in growth
21 doesn't mean that Asuris could not, if it is, indeed, a
22 long-term trend reduction in growth, could not continue to
23 expand if Premera tried to raise prices, does it?

24 A Yeah. It depends upon answering those other questions that I
25 put forward. We just don't know.

1 Q You don't have any data that you can present to the
2 Commissioner on whether there's any barriers to Asuris
3 expanding its coverage of people if Premera has a substantial
4 increase in its price, do you?

5 A I've seen no data one way or the other on this.

6 Q I understand. And you haven't created any data or made any
7 determination, have you?

8 A No, I have not.

9 Q Now, you're not proposing that a one-year change constitutes
10 a trend in Asuris's growth though, are you?

11 A Well, we've only seen a couple of years' worth of evidence.
12 So there's one up, one slowing down.

13 Q So you, yourself, are just making an observation. You've
14 made no study in regard to Asuris's growth, is that correct,
15 to just wrap up on that?

16 A I'm making the same kind of observation I'm making with
17 respect to Asuris's lack of growth on the individual side.

18 Q You don't know whether it's a trend one way or the other?

19 A That's true.

20 Q Now, let me just . . . Really - I think we had some
21 testimony on Dr. Leffler's market share. And you explained,
22 by analogy, the Boeing Company.

23 A Mm-hmm.

24 Q Okay. Now let me just see if I understand it. You're
25 saying, well, it would be hard for Boeing to switch from

1 making 747's to Piper cubs.

2 A No. I didn't say it would be hard.

3 Q Okay. What did you say about that?

4 A I said that their market share in making Boeing 747's is not
5 necessarily relevant to the market share that they would
6 achieve if they started making small aircraft.

7 Q Wasn't that what Dr. McCarthy was saying throughout his
8 testimony, that market share isn't that important; you really
9 need to look at process, and the final issue is whether or
10 not you have market power?

11 A Dr. McCarthy still talked about market shares of 20 something
12 percent.

13 Q Sure.

14 A And I'm simply trying to point out that one should not
15 interpret those unless you understand the context of how the
16 calculation is being made.

17 Q And one thing I've heard repeatedly in these depositions and
18 testimony is that mere market share alone doesn't constitute
19 market power. Is that true?

20 A That's correct.

21 Q Didn't people say you could have as much as close to a
22 hundred percent of market share and still not have market
23 power?

24 A Yes. That is correct, too.

25 Q Because - correct me if I'm wrong - the market power means

1 you have an ability to have sustained success for higher
2 prices; isn't that true?

3 A That's correct.

4 Q Okay. Well, I guess let's just understand a little bit.
5 You're not suggesting that because it would take Boeing years
6 to research and develop a new plane and have to put in new
7 tools, new assembly line, hire new workers, that that's
8 somehow analogous to the ease and speed with which a health
9 insurance company could say, "We're going to expand what we
10 do in one state into Washington," and set up business and
11 expand their coverage in Washington, are you?

12 A What I'm saying is that the calculation of market share
13 requires considering how much resources get shifted in a
14 response to price changes. And the market share that Boeing
15 has in the large aircraft has nothing to do with the market
16 share they could achieve in the small aircraft even if they
17 could do it instantaneously.

18 Q Because they'd be devoting resources in different areas. Is
19 that what you're saying?

20 A Basically.

21 Q But if they had a capacity or were ready to handle claims, if
22 they had a network of doctors already and hospitals already
23 available, if they had relationships with brokers, that isn't
24 - there wouldn't be any barrier for them saying, "Gee,
25 Premera's charging that much higher price. We're going to

1 offer our product that we offer elsewhere here in Eastern
2 Washington." Isn't that true?

3 A Well, as Dr. Leffler described, we're starting to confuse two
4 different things, barriers and calculation of market share.

5 Q And you don't disagree with Dr. Leffler's conclusion that the
6 - even if you assume that Premera had some market power in
7 Eastern Washington in the individual and small group lines,
8 that those markets are effectively competitive due to
9 regulation?

10 A Could you repeat the question. I'm sorry.

11 Q You don't disagree with Dr. Leffler's conclusion that even if
12 Premera had market power in Eastern Washington in individual
13 and small lines, that those markets are effectively
14 competitive due to regulation, do you?

15 A I think what he said was that there is market power in those
16 lines in parts of Eastern Washington but that the prices may
17 currently be set at competitive levels. That's different
18 than saying that they are competitive.

19 Q Didn't he also say that whatever market power they had had
20 been exhausted or utilized?

21 A No. That was with respect to the buying side.

22 Q Buying side. Now, you talked a little bit about elasticity.
23 I hesitate to go into that area too much. You set it in your
24 model at a very - what's the right term - small elasticity,
25 low elasticity?

1 A I set it in my model at a level that's consistent with the
2 assumption that there is market power in the first place,
3 which comes from the work that Dr. Leffler's done.

4 Q But it was, in any event, a small elasticity? Is that what
5 it's called? A lower number?

6 A I'm not exactly sure what you mean by small. But it is a
7 number that is consistent with the definition of market
8 power.

9 Q I guess let's see if we understand this. Not very elastic.
10 Is that the right term? That would mean that people do not
11 easily switch?

12 A Yes, within the relevant range of prices that I'm studying.
13 I looked at a range of elasticities that are not very
14 elastic.

15 Q And the numbers that you used were .05?

16 A That's at one end of the range.

17 Q Right. And the other end range is --

18 A Just above one.

19 Q And higher elasticity, where people would more readily
20 switch, you're talking about two, is that correct, and so
21 forth? That's the way you go if you wanted higher
22 elasticity, the bigger numbers?

23 A That's correct. They're technically negative numbers. But
24 usually people talk about them in absolute value.

25 Q And I won't even ask you why. Now, and you based - you have

1 a footnote in your report, as I understand it, remember it,
2 in which you find support you say in the literature for the
3 elasticity number that you used; is that correct?

4 A Yeah. There was a survey that was done that - where at least
5 other studies found elasticities that were in the same range
6 as the numbers that I chose.

7 Q Okay. And that study that was done was by Royalty and
8 Solomon?

9 A I think that's the name of the authors.

10 Q Okay. And then you also took a look at a paper by Cutler and
11 Reber; is that correct?

12 A Oh, I'm sorry. Maybe I misspoke. There was a survey that
13 was done which cited a number of individual studies.

14 Q Okay. And did it cite the Royalty and Solomon study?

15 A You know, if I take a look at my - my report, that would help
16 me.

17 Q Why don't you do that. It's page 90, footnote 71. Is that
18 right? That would be P-22.

19 MR. HAMJE: Actually the admitting exhibit is
20 S-20.

21 MR. KELLY: S-20.

22 A So yes . . .

23 Q (BY MR. KELLY) Slow down. We all need to get to our
24 elasticity text here.

25 JUDGE FINKLE: What page? Sorry.

1 MR. HAMJE: Page 90 of S-20.

2 Q (BY MR. KELLY) Okay. And you see footnote 71; is that
3 correct?

4 A That's correct.

5 Q Okay. And then the first study that you cite is Cutler and
6 Reber; is that correct?

7 A Yes.

8 Q Okay. And that gives a - this elasticity of negative 0.3 and
9 negative 0.6 while studying the enrollment changes due to a
10 change in out-of-pocket premiums; is that correct?

11 A That's correct.

12 Q Now, out-of-pocket premiums though is only half the story,
13 isn't it? Let me ask you the question this way: That means
14 that the employee has to pay some out-of-pocket premiums.
15 And this demonstrates the elasticity for that employee; true?

16 A That is true.

17 Q But the other half of the story is that the employer also has
18 to pay the premium.

19 A Yes.

20 Q And didn't Cutler and Reber also talk about what happens to
21 the elasticity for the employer?

22 A I don't recall. They may have.

23 Q I do have it. It's P-95. Take a look at that study for a
24 minute. Actually, to save everyone from having to open these
25 books up, I made some copies, if I can find them. I can't

1 find it. I'm sorry. You're going to have to open up the
2 books.

3 If you would turn for a minute to P-95. I think John
4 is going to get a copy for you, and everyone else will get
5 their copies. Okay. Do you have P-95 in front of you there?

6 A Yes, I do.

7 MR. KELLY: I'll move to admit P-95.

8 MR. HAMJE: No objection.

9 MS. HAMBURGER: No objection.

10 JUDGE FINKLE: Admitted.

11 Q (BY MR. KELLY) Now if you would turn your attention to page
12 14 of this paper. And you'll see the first full paragraph
13 that begins with, "These estimates"? If you would just read
14 that to yourself for a moment.

15 A (Witness complying.) Yes.

16 Q And that's where you got the - that refers to what you put in
17 your footnote about the negative 0.3 and negative 0.6 for the
18 out-of-pocket premiums for the employees; is that correct?

19 A That's correct.

20 Q Okay. And now if you would read the next paragraph to
21 yourself for a moment, "That price elasticity," and then tell
22 me when you've finished reading.

23 MR. HAMJE: If I could interrupt here for just a
24 moment, on my copy, which is - I have a copy of P-95, there
25 are some notes in the margins that look like they've been

1 handwritten in there. Does everybody else have that as well?

2 MR. KELLY: I'm afraid they do. I didn't write
3 them. Someone did. They should be deleted. And I'm not
4 going to be referring to them. Apologize for that. We'll
5 substitute the page.

6 MR. HAMJE: No. I just wanted to clarify. Thank
7 you.

8 Q (BY MR. KELLY) Are you finished reading that paragraph?

9 A Yes.

10 Q If I could just read it into the record, and tell me if I'm
11 reading this right. The last sentence says, "Thus, the price
12 elasticity with respect to the total premium is roughly four
13 times the price elasticity with respect to the out-of-pocket
14 premium. Our estimates of the price elasticity with respect
15 to total premiums are, therefore, about negative two."

16 Did I read that correctly?

17 A Yes. And if you don't mind, can I keep reading? "Our demand
18 elasticities are higher than traditional estimates of demand
19 responsiveness but are in line with some other recent work."

20 Q Okay. Fine. But you cited in your footnote Cutler and
21 Reber, and you only cited one-half of the story; isn't that
22 true?

23 A Yeah, I think --

24 Q Can you just answer that yes or no, sir. Did you only cite
25 the out-of-pocket premium? Yes or no?

1 A That's all we cited.

2 Q Okay. And if one were to use a negative two elasticity, that
3 would indicate a much higher elasticity than - in fact, four
4 times higher, than the one that you cited from Cutler and
5 Reber; isn't that true?

6 A That's how the math works. But that wouldn't be consistent
7 with the assumption anymore.

8 Q I understand. But you did drop the footnote to support your
9 position, did you not?

10 A We reported the information from the survey study. And the
11 survey study unfortunately only had reported that portion.
12 So we should have taken the information from the full report.

13 Q Another way to put that is you didn't read the Cutler and
14 Reber report before you cited it. Isn't that true?

15 A I don't recall whether or not one of my staff persons read it
16 or not. But we cited the information from the survey report.

17 Q I know you did. But you didn't read it yourself, did you?

18 A No, I did not.

19 Q And you have no knowledge one way or the other whether your
20 assistant read it; isn't that true?

21 A As I said before, we took it from the survey article.

22 Q I understand. My question is: You don't know one way or the
23 other whether your assistant read the actual Cutler and Reber
24 report, do you?

25 A No, I do not.

1 Q Now, you also cite the Royalty and Solomon report in this
2 footnote, do you not?

3 A Yes, again coming from the survey article.

4 Q I understand. If you would take a look at page - Exhibit
5 P-98. That's a copy of that report.

6 A Okay.

7 Q And sorry to make you go back to footnote 71, but it does say
8 that you cite that report for the proposition of an
9 elasticity of negative 1 to negative 1.8; is that correct?

10 A Yes.

11 Q And again, that - your footnote says that's the employees'
12 side of the equation for the Stanford University employees;
13 correct? Starts at the bottom of footnote 71.

14 A Yeah. Yes.

15 Q Okay. Now if you would look at Exhibit P-98, that's the
16 Royalty and Solomon report. And I would ask you to take a
17 look if you would for a minute at the bottom of page 33 and
18 the top of page 34.

19 MR. KELLY: And I will also move to admit P-98.

20 MR. HAMJE: No objection.

21 MS. HAMBURGER: No objection.

22 A Which page?

23 Q (BY MR. KELLY) I'm sorry. Bottom of page 33 under
24 "Conclusion."

25 JUDGE FINKLE: Admitted.

1 MR. KELLY: Sorry.

2 Q (BY MR. KELLY) And you're welcome to read the entire
3 paragraph. But I'm interested in the sentences - completion
4 of that paragraph that start two lines up, "From the
5 'insurer-perspective.'" And then let me know when you've
6 finished reading the paragraph.

7 A Yes.

8 Q And I'd just like to read it into the record and tell me if
9 I've read it correctly, this one sentence that starts at the
10 bottom of page 33.

11 "From the 'insurer-perspective' (using the total
12 premium rather than employee-paid premium as the base price
13 for calculating percentage price increases), elasticities
14 range from negative 1.0 to negative 1.8 in full sample simple
15 logic estimations or from negative 3.7 to negative 6.2 in the
16 preferred fixed effects model."

17 Did I read that correctly?

18 A It's logit. But otherwise, yes.

19 Q Logit. Now, again looking back at your exhibit, your
20 footnote 71, there is no mention in there that there's
21 another half to the Royalty and Solomon calculations that
22 goes from negative 3.7 to negative 6.2, is there?

23 A No, there isn't.

24 Q Negative 6.2 is very high or great elasticity; isn't that
25 true?

1 A It still is not perfect competition but it's certainly higher
2 than - well, an absolute value higher than negative 1.8.

3 Q Thank you, sir. That's all we have on those exhibits. And
4 now I'd like to talk for a few minutes about your model. And
5 there are two things I wanted to discuss about the model.
6 First is certain general principles about modeling and then
7 as to whether there's any problems with your model. Now,
8 first of all, modeling, I think you agree - you agree, is
9 only as good as its data; correct?

10 A That's a - that sounds like a reasonable general principle.

11 Q And it's also only as good as its assumptions; is that
12 correct?

13 A Well, a model - I mean conclusions are - come out of
14 assumptions. So I don't know that the model itself is
15 predicated on assumptions.

16 Q Well, if the model --

17 A The analysis is.

18 Q Okay. If the model - assumptions are what drive the model,
19 then the model doesn't particularly tell us very much, does
20 it? It says if this is the case - assuming this is the case,
21 then what would happen. But it doesn't . . . Let me
22 rephrase it. The model doesn't prove any of its assumptions,
23 does it?

24 A Well, the model perhaps always works with its assumptions.
25 The question is whether or not the assumptions themselves

1 hold up.

2 Q Okay. And when I was asking you similar questions about
3 principles of modeling in your deposition, I think you agreed
4 with me that because of the problem of, well, depends on how
5 good your data is and how appropriate your assumptions are,
6 that models are subject to the phenomenon of garbage in,
7 garbage out; isn't that true?

8 A Can be.

9 Q Now let's talk a little bit about the model that you
10 developed. And as I understand it, it says if Premera were
11 to set its premiums and reimbursements so as to achieve
12 certain target margins, how high would those premiums get and
13 how low would reimbursements have to be in order to achieve
14 the target margins. Is that correct?

15 A Essentially.

16 Q Okay. And were you here yesterday when I was questioning
17 Ms. Hunt?

18 A Yes.

19 Q Okay. And I tried to use this - this idea of, well, is that
20 similar to if you were a consultant and you made \$100,000 a
21 year and you had a \$50 an hour rate. You could develop a
22 model that says assume that you want to make \$300,000 next
23 year. How much - how high are you going to have to set your
24 hourly rate in order to achieve that target?

25 A I recall you . . . Yeah.

1 Q And I think she said that was a good comparator, as a general
2 understanding, to your model.

3 A I think she might have. I don't --

4 Q And do you agree with that?

5 A In a very simplistic form.

6 Q That's kind of the way sometimes we all are. So your model,
7 just to be clear, doesn't predict that premiums or rates are
8 going to go up, does it?

9 A No, it does not.

10 Q Okay. Now, the first question I had about your model
11 is . . . Let me rephrase it and ask it differently. Your
12 model does not have any regulatory constraints in it, does
13 it?

14 A No. The model does not. It assumes that regulatory
15 constraints are relaxed enough that prices can go up.

16 Q So that's another assumption in your model; isn't that true?

17 A Yeah. That's what I said.

18 Q It is possible to build a model with regulatory constraints,
19 is it not?

20 A Well, it would be a pretty complicated model in this case I
21 think.

22 Q Well, you certainly had a lot of time and a lot of money to
23 devote resources --

24 MS. HAMBURGER: Objection. Argumentative.

25 JUDGE FINKLE: Sustained.

1 Q (BY MR. KELLY) Well, you're not saying that it was any lack
2 of resources that stopped you from developing a more
3 complicated model that would actually include constraints,
4 are you? Yes or no?

5 A There was not a lack of resources that stopped me from
6 including the regulatory restrictions.

7 Q Okay. Now, as I understand it - let's talk a little bit more
8 in detail on this - the model involves a comparison of
9 revenue and cost on a county-by-county basis; is that
10 correct?

11 A Yeah. That's essentially correct. They are aggregated.

12 Q Okay. You mean they are aggregated - later you bring up from
13 county to county up to Eastern Washington. Is that what you
14 mean?

15 A Up to groups of 16 and 18 and the others.

16 Q Now, you were aware of the various definitions of county data
17 that Premera has in its operations, are you not, or were you
18 not?

19 A I'm not sure I understand your question.

20 Q Okay. Wasn't very well phrased. Premera collects its data
21 in certain ways, does it not?

22 A Yes, probably true.

23 Q And it collects its data regarding premiums in a certain way;
24 is that correct?

25 A Yes.

1 Q And location of subscriber in a certain way?

2 A Yes.

3 Q And it also collects its data regarding costs in a certain
4 way; is that true?

5 A That's true.

6 MR. KELLY: Okay. And I would like everyone to
7 turn their attention to P-155. This time I have copies,
8 which I think will be easier to use.

9 JUDGE FINKLE: Counsel, let's give counsel an
10 opportunity to locate it.

11 MR. KELLY: Oh, I'm sorry. John, do you have it?

12 MR. HAMJE: I do. Thanks.

13 Q (BY MR. KELLY) All right. Dr. Gold, I'd ask you to take a
14 look at page 2 of Exhibit P-155. And halfway down the line,
15 there's an entry called "County." And I would ask you, if
16 you would for a moment, to just read the paragraph starting
17 "County information" and then let me know when you've
18 finished reading.

19 A (Witness complying.) Okay.

20 Q So first, for line of business, it says, "County is defined
21 as the county in which the group's headquarters is located."
22 Is that correct?

23 A That's correct.

24 Q And then, "For medical claims, county is defined as the
25 provider's county," in other words where the physician or

1 hospital is. Is that correct?

2 A Yes. That's correct.

3 Q And then skipping down to the last sentence, "For the
4 enrollee or the subscriber, county is defined as the county
5 of the enrollee's mailing address." Correct?

6 A That's correct.

7 Q Now, a lot of tertiary care is provided in Western Washington
8 for those who live in Eastern Washington, is there not, to
9 your understanding?

10 A I don't know if it's a lot. But I know that tertiary care is
11 provided in Western Washington. I'm sorry. Maybe that . . .
12 Can you repeat the question.

13 Q Yes. Let's just phrase it: Is tertiary care - that would be
14 right, like for heart operations, for example - provided
15 often to Eastern Washingtonians by them going to Western
16 Washington?

17 A I certainly know it occurs.

18 Q And you didn't do any test to extend - to determine the
19 extent to which that occurs in Eastern Washington, did you?

20 A Well, as I'm sure you're going to get to in the data, we see
21 some places where the claims are likely taking place because
22 of that. I didn't study it independently of the data.

23 Q But in terms of where Premera allocates reimbursement cost
24 for a person living in Eastern Washington, say in Okanogan,
25 who happens to go to Seattle for some heart care, the claims

1 are made - the costs are put in a bucket, or whatever you
2 want to call it, for King County, not for Okanogan County;
3 correct?

4 A That's correct.

5 Q And if that same individual happens to work - or go for his
6 or her regular primary care down to Wenatchee, then those
7 costs are put against whatever the county - Kittitas County,
8 I guess; is that correct?

9 A If I followed your question, I think that's right.

10 Q Okay. Now, it's possible that that person who lives in
11 Okanogan County may be in a small group which might be
12 headquartered in Spokane. And if that's the case, the
13 premiums would go not to Okanogan County, but to Spokane
14 County; isn't that correct?

15 A That's right. It's the plug in the data that captures, also.

16 Q And then furthermore, the - it's possible that that person's
17 headquarters is actually in Tacoma and so the money would be
18 allocated as premiums over in Western Washington, isn't that
19 true?

20 A That is true.

21 Q Okay. Now, originally the work on this model was done by a
22 gentleman named David Cooper; isn't that correct?

23 A Originally David began the work on this, yes.

24 Q Okay. And then he left the company and then you took over;
25 is that correct?

1 A That's correct.

2 MR. KELLY: I have two other exhibits that I'm
3 going to discuss now that I would like to - I have copies for
4 the Commissioner and Staff and for the witness. Those are
5 P-156 and P-157. And if you would just take a few moments to
6 read through both of those and let me know when you're done,
7 Mr. Gold.

8 By the way, if I could - I hate to interrupt your
9 reading - but before I forget, I move to admit P-155,
10 Definition of Counties.

11 MR. HAMJE: No objection.

12 MS. HAMBURGER: No objection.

13 JUDGE FINKLE: Admitted.

14 A Okay.

15 Q (BY MR. KELLY) Now, turn your attention first to P-156. And
16 if you'd turn to the second page, under "Data." And I'm
17 going to ask you about the third bullet point. And for the
18 record, let me read this into the record. See if I'm reading
19 it right. Quote, "Mismatch of geographic reporting system
20 between revenue side (by address of end client) and cost side
21 (by hospital or other provider). Resolving this issue is
22 absolutely crucial," crucial being bold in the text, "to the
23 reliability of our model."

24 Did I read that correctly?

25 A Yes, you did.

1 Q And that was an attachment that Mr. Cooper made on
2 February 27th, 2003 and sent to Ms. Hunt and others; is that
3 correct?

4 A That's correct.

5 Q And Ms. Hunt never forwarded this e-mail on to you after
6 Mr. Cooper left; isn't that correct?

7 A Well, I knew of the issue.

8 Q My question is: Was this e-mail ever forwarded on to you?

9 A I don't think so.

10 MR. KELLY: Move to admit Exhibit 156.

11 MR. HAMJE: No objection.

12 MS. HAMBURGER: No objection.

13 JUDGE FINKLE: Admitted.

14 Q (BY MR. KELLY) And then if you can turn your attention to
15 Exhibit 157 which is an e-mail from Mr. Cooper on to
16 Ms. Murphy and Ms. Hunt about a month later, March 28th,
17 2003. This is his goodbye e-mail, I believe. At least
18 that's what he says in the final paragraph. And he talks
19 about in the middle paragraphs the main remaining challenges
20 slash tasks. Do you see that paragraph?

21 A Yes.

22 Q And under A, he says, in part - and tell me if I'm reading
23 this correctly - "Achieve a sensible formatting of the key
24 input variables. This is particularly critical with respect
25 to the much discussed 'mismatch' between the accounting for

1 healthcare cost and premium revenue on a by-county basis."

2 Did I read that correctly?

3 A Yes.

4 Q And under B he says, quote, "Define logical input parameters
5 to avoid a classic 'garbage in garbage out' scenario. There
6 is a lot to do here, including finalizing reasonable criteria
7 for measuring market power and incorporating various
8 constraints (regulatory or otherwise) that create bounds
9 (upper and/or lower) for Premera's behavior."

10 Did I read that correctly?

11 A Yes, you did.

12 Q And no - I think you previously testified no regulatory
13 constraints were built into the model that you created. Is
14 that correct?

15 A That would be really a lot to do.

16 Q Okay. And finally, this memo was not forwarded to you by
17 Ms. Hunt either, was it?

18 A Well, I recall seeing it before. I know at our deposition.
19 I don't recall whether or not I saw it earlier or not.

20 MR. KELLY: Fair enough. No further questions.
21 Thank you. Oh, I'm sorry. Move to admit Exhibit 157.

22 MR. HAMJE: No objection.

23 MS. HAMBURGER: No objection.

24 JUDGE FINKLE: Admitted.

25 MR. KELLY: Thank you.

CROSS-EXAMINATION

BY MS. McCULLOUGH:

Q Other than raising rates, are there ways for the insurance company to achieve growth in operating income?

A Holding all else equal, adding members might be another way.

Q Are there any other ways?

A Lowering costs.

Q Okay. So if an insurance company were to raise its rates, thereby resulting in membership fall-out, an insurance company could still achieve growth in operating income; is that right?

A It's possible. It depends on how much the membership fall-out is.

Q So notwithstanding potential membership fall-out, then as a for-profit, Premera might be able to raise rates to meet investor expectations of higher profit margins; is that right?

A It seems like a reasonable assumption.

MS. McCULLOUGH: Thank you.

JUDGE FINKLE: Anything else from Intervenors?

MR. MADDEN: (Shakes head.)

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REDIRECT EXAMINATION

BY MR. HAMJE:

Q Dr. Gold, when you were being questioned, you were asked a number of times about . . . With respect to the factors that you discussed in your direct testimony, you were asked about whether or not you had prepared a study. In connection with development of those factors, what did you rely upon?

A I relied on the work of the other members of our - of our team and the work of Dr. Leffler and ultimately my review of all of Dr. McCarthy's materials as well.

Q In connection with the model, when you were discussing the model --

A Can I add one more point?

Q Sure.

A Also the testimony of a lot of other people in this proceeding. Sorry.

Q Again, let me get back - I also want to ask you about the model. You were asked some questions about the costs not being taken into consideration in connection with your model. Do you recall that testimony?

A The administrative costs or --

Q Yes.

A Yes, I do.

Q Can you explain why you did not include those costs?

1 A Because I was using Premera's projected financial projections
2 as my baseline.

3 Q And why is it then there were no - why is it then that you
4 didn't use costs? Are they not in the --

5 A Oh, no, I'm sorry. They are in there. They're just the
6 costs that are in there based upon the financial projections
7 that I believe were filed in the Form A filing.

8 Q You were also asked some questions about the studies -
9 several studies that were footnoted in your report. Do you
10 recall that testimony?

11 A Yes.

12 Q Could you please explain the context of why you used the data
13 from the survey in your report?

14 A The survey was basically just to check on the reasonableness
15 again of the assumption that there could be market power and
16 that, therefore, to be consistent with market power, I was
17 choosing an elasticity of - in the right range for market
18 power. Some of the cited studies in the literature review
19 indicated elasticities in that same range.

20 Q And you were also asked about why you did not use regulatory
21 or you were asked about why regulatory restrictions were not
22 used in your model. Do you remember that testimony?

23 A Yes.

24 Q Why didn't you include regulatory restrictions in your model?

25 A Well, one of the assumptions was that there weren't

1 regulatory restrictions that would prevent the price
2 increase. So there's really no need to then build in an
3 entire regulatory model.

4 I guess the other reason is basically that it would be
5 I think extremely complicated to try to model the entire
6 regulatory environment as needed.

7 And we were able to make some judgments with respect to
8 the profitability and their relationship to certain
9 regulatory constraints and know that we were, in general,
10 consistent with what our understanding was of the regulatory
11 environment.

12 Q You were also asked some questions about a couple of
13 exhibits, P-156 and 157 and, in particular, about an issue
14 that has been described as mismatch.

15 A Yes.

16 Q And were you previously aware of that issue?

17 A Yes.

18 Q Was that - how did you resolve that issue?

19 A Well, we resolved the issue by basically understanding what
20 it meant to the way that margins between east and west are
21 affected and considering the fact that I'm trying to
22 basically move the entire statewide margins up. I have a
23 slide that can give a longer answer to that example. But
24 essentially when you add together the east and the west
25 groups of counties, you're trying to move the total amount of

1 operating margin - of operating profits up by a certain
2 amount.

3 So if . . . Basically the problem that Mr. Kelly is
4 referring to in the small line of business, for example,
5 makes the west look less profitable than it actually is and
6 the east look more profitable than it actually is when you
7 use the county-level data. That was still the best data to
8 use for this particular analysis. But if you aggregate the
9 two sides together, which ultimately I do in the analysis,
10 you might have say \$10 in profits on the west side and \$1 in
11 profit on the east side. Add them together, you get 11. If
12 you have to get to 12, you need to add one. But just because
13 you moved the profits around from the east to the west first
14 and made it 10 and a half and half - 10 and a half in the
15 west and half in the east - you still started with 11. You
16 still have to get to 12. You still just have to add one.
17 The absolute gap is the same.

18 The percentage increase in prices have to do with where
19 you start from, the base. And because Mr. Kelly had asked me
20 so many questions about this in my deposition, I actually
21 followed up with and tried to test this by actually moving
22 the revenues and costs around and concluded that, as I did at
23 the deposition --

24 MR. KELLY: I'm going to object to this. This is
25 beyond the scope of cross. It is apparently new data that

1 was not in his pre-filed responsive. And it certainly is
2 something that is - comes as a - too little too late I
3 submit.

4 JUDGE FINKLE: Overruled.

5 A As I was saying, I tested what would happen if you moved the
6 data around. I had described in my deposition why,
7 theoretically, you didn't really even need to do that; you
8 already knew mathematically it would work. And in fact, it
9 turned out that the answer was still within the range of
10 eight to ten percent or two to four percent.

11 Q (BY MR. HAMJE) And Dr. Gold, you were also asked by
12 Mr. Kelly about P-157 and also about the - what was termed a
13 challenge or task that was contained in B about the input
14 parameters, the definition. Was that an issue about which
15 you were aware?

16 A Yes.

17 Q And was that issue also resolved?

18 MR. KELLY: Objection. Leading the witness.

19 JUDGE FINKLE: Overruled. I think it's
20 preliminary to the next question. You may answer.

21 A Can you repeat the question.

22 Q (BY MR. HAMJE) I just asked whether or not the issue was
23 resolved.

24 A To my mind.

25 Q How was it resolved?

1 A I set out certain assumptions and considered whether or not
2 they were reasonable, within the scope of my expertise.

3 Q And you were also, during your testimony, asked - or
4 cross-examination, asked about a situation in which a new
5 entrant into the market could rent a network for a dollar per
6 member per month. Do you recall that testimony?

7 A Yes.

8 Q Do you have any information as to whether a dollar per member
9 per month is a reasonable estimate of that rental cost?

10 A Actually I recall Dr. Leffler talking about \$3 per member per
11 month, I think. That's my recollection from his report.

12 MR. KELLY: Counsel, just to be clear, that was
13 not - that was a hypothetical number to show if there's a \$3
14 increase, \$1, \$1. I'm not claiming you can rent it. I have
15 no idea.

16 Q (BY MR. HAMJE) And if Premera were to increase its prices by
17 four percent, do you have an opinion as to whether many
18 Premera members would switch to Asuris?

19 A In the individual line of business, you know, it certainly is
20 within the switching costs. And that had been talked about
21 by Dr. Leffler and Ms. Hunt.

22 MR. HAMJE: That's all I have. Thank you. Thank
23 you, Dr. Gold.

24 MR. KELLY: I have no redirect - or recross.

25 MS. HAMBURGER: Nothing.

1 JUDGE FINKLE: Thank you. Please step down.

2 MR. HAMJE: May this witness be excused?

3 JUDGE FINKLE: He may. We'll take a break.

4 (Morning recess.)

5 JUDGE FINKLE: Ready to proceed.

6 MR. MADDEN: Your Honor, Commissioner, we have on
7 the telephone Cal Pierson, who, with the indulgence of all
8 the other parties, is being called by the Hospital
9 Intervenors at this time. Assume you would like to have him
10 raise his right hand and be sworn, your Honor.

11 JUDGE FINKLE: Yes. Please raise your right hand.

12

13 CALVIN PIERSON, appearing by telephone, having been
first duly sworn by the Judge,
14 testified as follows:

15

16 DIRECT EXAMINATION

17

18 BY MR. MADDEN:

19 Q Mr. Pierson, would you tell us your name --

20 JUDGE FINKLE: Use your mic.

21 Q Mr. Pierson, would you tell us your name and professional
22 address, please.

23 A Yes. My name is Cal Pierson. I'm president and CEO of the
24 Maryland Hospital Association, which is located at 6820 Deer
25 Path Road in Elk Ridge, Maryland.

1 Q Are you the same Calvin Pierson who has previously submitted
2 written testimony in this proceeding?

3 A Yes, I am.

4 Q Mr. Pierson, since you're testifying by telephone, would you
5 tell us where you're physically located at this time and
6 whether there's anyone else present with you in the room.

7 A Yes. I am in my office alone at the Maryland Hospital
8 Association.

9 Q Would you briefly describe for us your responsibilities with
10 the Maryland Hospital Association, including the length of
11 time that you've been the president.

12 A Yes. I've been president and CEO of the Maryland Hospital
13 Association for going on 13 years. I lead the organization
14 of 85 staff and we have 68 member hospitals. And the
15 association is the advocate for hospitals and their patients
16 in Maryland, and we advocate to Legislature, governor's
17 office, regulatory agencies and other entities.

18 Q All right. Have you provided us with a copy of your resume?

19 A Yes, I have.

20 MR. MADDEN: Your Honor, we've marked that as
21 Intervenor's Exhibit 17.

22 Q (BY MR. MADDEN) Mr. Pierson, does the resume that you've
23 provided accurately summarize your experience and training?

24 A Yes, it does.

25 MR. MADDEN: We'd offer I-17 at this time.

1 MR. KELLY: No objection.

2 MR. HAMJE: No objection.

3 JUDGE FINKLE: Admitted.

4 Q (BY MR. MADDEN) Mr. Pierson, you've also, as you indicated,
5 filed written direct testimony in this matter. Do you wish
6 at this time to make any corrections to that written
7 testimony?

8 A Yes. There's a change of one word in section 9 of that
9 testimony that I'd like to change either now or later in the
10 proceeding.

11 Q All right. Is that paragraph 9 that you're referring to?

12 A Yes.

13 Q And that's on page 4 of your written testimony?

14 A That's correct.

15 Q What is the change that you would like to make?

16 A In three instances in that paragraph, I used the word
17 premiums. And the substitution is to change that term to
18 revenue. The essential point remains the same. It's just a
19 different reference to the revenue base of the calculation.

20 Q Are there any other corrections that you wish to make?

21 A No.

22 Q Do you adopt and affirm your written testimony as your sworn
23 testimony in this proceeding?

24 A Yes, I do.

25 Q As corrected?

1 A Yes.

2 MR. MADDEN: We'd offer I-16 at this time, your
3 Honor.

4 MR. KELLY: No objection.

5 MR. HAMJE: No objection.

6 JUDGE FINKLE: Admitted.

7 Q (BY MR. MADDEN) Mr. Pierson, were you the president of the
8 Maryland Hospital Association during the CareFirst conversion
9 proceedings?

10 A Yes, I was.

11 Q During - in connection with the CareFirst conversion in
12 Maryland, did your association conduct a review of
13 CareFirst's proposal?

14 A Yes. We had an extensive six-month process that involved
15 lots of outside organizations and individuals and we had a
16 steering committee of hospital CEO's and trustees that ran
17 that process.

18 Q Specifically as a part of the hospital associations review,
19 did you survey the behavior of for-profit converted Blue
20 plans as it impacted providers?

21 A Yes, we did. We surveyed converted Blue plans in five
22 different states and we looked at both the impact on
23 providers, but even more importantly, on their impact on
24 subscribers and overall issues of public accountability.

25 Q Could you briefly explain how you went about gathering this

1 information.

2 A Yes. My staff and I spoke with the president and CEO of five
3 different state hospital associations, in California,
4 Connecticut, Colorado, Georgia and Kentucky. We did a phone
5 survey of those states based upon the same questions for
6 each.

7 Q And what questions did you ask?

8 A Well, first of all, on the public accountability side, we
9 asked in five areas whether the behavior of the Blues plans
10 that had converted had changed from preconversion to
11 post-conversion. The five issues were the extent to which
12 the plan helped with the uninsured; secondly, the flexibility
13 of the plan in providing coverage to different groups, third,
14 responsiveness of the plan to state policy regulation and
15 legislation; fourth, service to subscribers; and fifth, the
16 level of denials of subscriber claims.

17 On the provider side, we asked about level of payment;
18 secondly, handling of disputed claims, whether that had
19 improved or gotten worse; and thirdly, contract negotiations,
20 whether they had gotten better or more difficult.

21 Q And are the results of your survey depicted in Exhibit C to
22 your pre-filed testimony?

23 A Yes. That's correct.

24 Q Okay. Could you explain briefly for the Commissioner what
25 the results were.

1 A Yes. Let me start with the five issues of public
2 accountability. What we found in each of the five states in
3 - across the five different areas of public accountability,
4 that in no case did those factors improve when the plans
5 converted from nonprofit to for-profit. In some situations,
6 there was no change in behavior. And in all other
7 situations, there was a diminished, a worse behavior, if you
8 will.

9 On the area of provider relations, we similarly found
10 that in most of the instances across the three questions, the
11 plan behavior got worse. And in the remaining instances, it
12 stayed the same. In no case did it improve.

13 Q Did your investigation also compare the percentage of revenue
14 spent on healthcare by nonprofit as compared to for-profit
15 Blue plans?

16 A Yes, we did. Would you like me to summarize?

17 Q Yes. If you could explain it, please.

18 A Yes. What we did is we relied heavily on work that was done
19 by a Carl Schramm. Carl is a noted healthcare economist.
20 He's also the former president of the Health Insurance
21 Association of America. He was asked by a foundation in
22 Baltimore to do some analysis in the year before Maryland
23 CareFirst was considering conversion to just look at the
24 policy implications of a potential conversion. And he looked
25 at situations across the country.

1 And one of the things he analyzed was the extent to
2 which the converted companies or for-profit companies, I
3 should say, versus nonprofit Blues plans, what percentage of
4 their total revenue they spent on medical costs. The
5 significance of that is obviously from both a subscriber and
6 a provider standpoint and a community standpoint, you want to
7 have a maximum percentage of your revenue actually going to
8 medical care as opposed to going to profits or administrative
9 costs or other things.

10 And what he found over a four-year period is that the
11 nonprofits spent an average of 84 percent of their total
12 revenue on medical costs, whereas the for-profit plans
13 averaged only 74 percent of revenue.

14 For us that's a significant issue because in the state
15 of Maryland, that could have meant several hundred million
16 dollars less with a converted Blue Cross plan potentially
17 going to medical care.

18 Q How do you mean several hundred million dollars less?

19 A Well, if you look in Maryland, for example, at Maryland
20 CareFirst and their total revenue and their total medical
21 expense base, if you assume the national experience as
22 Dr. Schramm outlined it, if you decrease from 84 percent of
23 revenue to 74 percent of revenue going for medical care, the
24 difference would be over \$200 million less going to medical
25 care.

1 Q Is that on an annual basis?

2 A Yes.

3 Q Mr. Pierson, in connection with the Maryland Hospital's
4 review of the CareFirst conversion proposal, did you attempt
5 to compare the corporate behavior of the plan - of the Blue
6 plan before it undertook conversion planning and its behavior
7 after it began planning to convert?

8 A Yes. Yes, we did. And there were some stark findings there.
9 What we found in the two-year period pre-application to
10 convert is that CareFirst in Maryland dropped participation
11 in Medicaid managed care program. They dropped participation
12 in the Medicare managed care program. And even more
13 significantly, they dropped roughly 5,000 subscribers from
14 coverage. These were high-risk subscribers, many of whom
15 were currently receiving substantial benefit from their
16 policy. They did this by closing their free state-managed
17 care plan and forcing subscribers to shift to their Blue
18 Choice plan and to go through medical underwriting. And as a
19 consequence, many people lost their coverage.

20 These - obviously CareFirst though still a nonprofit
21 company at that point, but what we saw was a company that was
22 positioning itself to be sold and to be converted to a
23 for-profit company with - where it would have to focus more
24 on Wall Street, if you will, than on Main Street.

25 MR. MADDEN: Thank you, Mr. Pierson. Those are

1 all the questions I have for you on direct examination.

2 JUDGE FINKLE: Would OIC like to ask any
3 questions?

4 MR. HAMJE: We have no questions.

5 MR. KELLY: I just have a few. Mr. Pierson, can
6 you hear me?

7 THE WITNESS: Yes, I can.

8 MR. KELLY: My name is Tom Kelly. I represent
9 Premera.

10

11

CROSS-EXAMINATION

12

13 BY MR. KELLY:

14 Q Now, you are the executive director of the Maryland
15 Hospital Association; is that correct?

16 A Yes. I'm the president and CEO.

17 Q Do you have both nonprofit and for-profit hospitals in your
18 association?

19 A We have largely nonprofit hospitals. We have one for-profit
20 hospital in the state of Maryland.

21 Q Okay. And did you happen to hear or be shown or be told
22 about the testimony of Dr. McCarthy, an economist that has
23 testified in this case?

24 A In the Washington state case?

25 Q Yes.

1 A No, I haven't. I'm sorry.

2 Q Okay. So you're not . . . Well, are you aware of any
3 tension that exists between the interests of subscribers in
4 keeping premiums down and the interests of providers such as
5 hospitals in getting higher reimbursement?

6 A Are you speaking of your situation or in general?

7 Q Our situation.

8 A No. I don't have any direct evidence of that, no.

9 Q Now, Mr. Pierson, are you categorically opposed to
10 conversions?

11 A No, I'm not.

12 Q So it depends on the facts and circumstances?

13 A Yes. That's correct.

14 Q Just wanted to ask you a few questions. I know that your
15 pre-filed testimony, you talked about in Maryland where you
16 questioned your or your association questioned whether the
17 Blue plan there needed access to capital. And you indicated
18 that you thought that that question should be asked here as
19 well. Is that correct?

20 A Yes. That's correct.

21 Q Do you have any reason to think that it's not being asked and
22 answered here as well?

23 A No. I presume, you know, because of some of the reasons
24 Premera has stated for its desire to convert, that that issue
25 is being fairly fully analyzed.

1 Q In your testimony, you referred to a health affairs article.
2 That refers generally to Blues' performances across the
3 country; is that correct?

4 A Yes. That's correct.

5 Q And the companies that it discusses are both for-profit and
6 not-for-profit; is that true?

7 A Yes. That's correct.

8 Q I wanted to ask you about your survey. Now, as I understand
9 it, this was the survey undertaken by your association; is
10 that correct?

11 A Yes, that's correct.

12 Q And it was commissioned to be submitted in opposition to the
13 conversion of CareFirst there in Maryland; is that true?

14 A Well, it wasn't commissioned per se. It was part of the
15 analysis that we did for our hospital trustees and CEO's to
16 give them a sense of whether this would be a desirable thing
17 and also to frame a set of principles that we would use to
18 assess the proposal by CareFirst. Our analysis was actually
19 done before the CareFirst proposal was put on the table. So
20 one of the things we were attempting to do, not knowing what
21 the proposal would be, is to fashion a set of objective
22 principles that we could use to gauge whether we would oppose
23 or support the proposal put forth by CareFirst.

24 Q Okay.

25 A And so the survey was done in that context as part of our

1 overall assessment.

2 Q But it was submitted to Maryland, was it not?

3 A It was submitted to who?

4 Q To the Maryland Commissioner.

5 A Yes, it was.

6 Q Okay. And the five . . . It involved five states, did it
7 not?

8 A Yes, it did.

9 Q And all five of those states were states that had just
10 recently had conversions; is that correct?

11 A Yes, within the past several years. Right.

12 Q So it wasn't just coincidence that you surveyed those states
13 that had had conversions. It was because you were interested
14 in that for purposes of a possible conversion of CareFirst;
15 isn't that correct?

16 A I'm sorry. I missed that question.

17 Q Well, I just wanted to make - to understand. You chose five
18 states, and those are the five states that had recently had
19 conversions, because you wanted to have some data to use in
20 regard to the conversion of CareFirst; is that correct?

21 A Yes.

22 Q And as I understand it, basically the survey consisted of
23 interviews that your association had with five hospital
24 association executives like yourself; is that correct?

25 A Yes. That's correct.

1 Q Okay. You talked also about Shram's report. That was done
2 in the context of the Kansas conversion; is that correct?

3 A I'm sorry. I missed the reference to what you're talking
4 about.

5 Q The Schramm report.

6 A The Schramm report. And what --

7 Q That was done in the context of the Kansas conversion; is
8 that true?

9 A No. No, it was not. It was done in the context . . . He
10 received a grant from the Abell Foundation in Baltimore,
11 which was interested in the whole notion of the potential
12 conversion of CareFirst in Maryland. It was done - and
13 although, as I said, it looked at Blues' conversions across
14 the country, it was done in reference to the Maryland
15 conversion, potential conversion.

16 Q Did that study base the calculations about the differences in
17 percentage payments on the basis of total revenues including
18 ASC slash ASO fees, or on premiums excluding ASC slash ASO
19 fees?

20 A As I just said in amending my testimony, it was based on
21 total revenue.

22 Q Okay. Now, there was another study done for the Insurance
23 Commissioner in Maryland by Feldman Wolley and Town
24 (phonetic); is that correct?

25 A I missed the reference to who you said.

1 Q Another study done for the Insurance Commissioner in Maryland
2 and it was done by Feldman Wolley and Town.

3 A I'm not familiar with that group.

4 Q Well, do you remember a study being done for the Insurance
5 Commissioner that found that conversion did not result in an
6 increase in premiums, but actually resulted in a slight
7 reduction in premiums?

8 A No, I don't.

9 Q Okay. And finally I wanted to talk with you about the
10 differences between the CareFirst transaction and Premera.
11 In the CareFirst transaction, a number of change-in-control
12 provisions were triggered as a result - or would have been
13 triggered as a result of the transaction; is that correct?

14 A Change in control in the sense that it was both a conversion
15 and a sale.

16 Q Okay.

17 A That's correct.

18 Q And CareFirst in that case was going to be acquired by
19 WellPoint, which was a national company; is that correct?

20 A Yes. That's correct.

21 Q And - but there was also another company called Trigon, which
22 also wanted to buy CareFirst; isn't that true?

23 A Yes. They had - they had likewise submitted bids earlier in
24 the process of a potential acquisition of the company.

25 That's correct.

1 Q And wasn't one of the issues in the conversion the fact that
2 the CareFirst board hadn't given Trigon a sufficient
3 opportunity to make a better offer than the one that
4 CareFirst ended up taking from WellPoint?

5 A Yes. That was one of many issues upon which the Commissioner
6 in Maryland turned down the proposed conversion and sale.

7 MR. KELLY: Thank you very much, sir.

8 MR. MADDEN: No further questions here.

9 MR. HAMJE: No questions.

10 JUDGE FINKLE: Thank you. We'll let you go.

11 THE WITNESS: Okay. You're welcome.

12 MR. KELLY: Before we get started with the next
13 witness, I have clean pages 14 from that study. Have you got
14 them?

15 MR. HAMJE: I have them. Yes.

16 MR. KELLY: I just wanted to give them to the
17 upper bench.

18 MS. CLARK: Do you remember the exhibit number it
19 was?

20 MR. HAMJE: It should be P-95. OIC Staff would
21 call Lichiou Lee.

22
23 LICHIOU LEE, having been first duly sworn by the
Judge, testified as follows:
24
25

1 DIRECT EXAMINATION

2

3 BY MR. HAMJE:

4 Q Please state your name.

5 A Lichiou Lee.

6 Q Please state your position and your employer.

7 A I am the lead health actuary at in the Insurance
8 Commissioner's office.

9 Q How long have you been working for the OIC?

10 A I've been working for OIC since 1995. In August it will be
11 nine years.

12 Q Please describe your educational background?

13 A I received my bachelor degree of mathematics in Taiwan and my
14 master's degree of mathematics from University of Montana.

15 Q Do you belong to any professional organizations?

16 A Yes. I am a member of the American Academy of Actuaries,
17 which is MAAA. And I'm also associated with the Society of
18 Actuaries.

19 Q Do you meet the continuing education requirements of the
20 MAAA?

21 A Yes, I do.

22 Q Are you qualified to render actuarial opinions under
23 Washington regulations?

24 A Yes, I do.

25 Q Please describe your responsibilities in your position at the

1 OIC?

2 A I review the rate filings filed by healthcare service
3 contractors and HMO's. And I also assist in drafting OIC's
4 regulations regarding the healthcare rating requirements.

5 Q Does your review of rate filings include review of Premera's
6 rate filings?

7 A Yes, I do.

8 Q Have you submitted pre-filed testimony in this matter?

9 A Yes, I have.

10 Q Does that include both direct testimony and responsive
11 testimony?

12 A Yes.

13 Q Do you adopt your pre-filed testimony?

14 A Yes, I do.

15 MR. HAMJE: At this time, the OIC Staff offers
16 Exhibits S-36, which is Ms. Lee's resume; S-51, which is her
17 pre-filed direct testimony; and S-52, which is her pre-filed
18 responsive testimony.

19 MR. KELLY: No objection.

20 MR. COOPERSMITH: No objection from the
21 Intervenors, your Honor.

22 JUDGE FINKLE: Admitted.

23 Q (BY MR. HAMJE) Please describe generally what you do when
24 you review rate filings.

25 A In general, there are three types of rate filings:

1 Individual, small group and large group. The individual rate
2 filings are for OIC's information only. The small group rate
3 filings are filed for review subject to disapproval by OIC.
4 The large group rate filings are also filed for review
5 subject to disapproval, too. But there is a regulation in
6 healthcare service contractors and HMO's that allow carriers
7 to negotiate a large group rate. So the OIC usually does not
8 disapprove the large group rates simply because those rates
9 are negotiable.

10 Q Please describe generally how small group rates may vary?

11 A The small group rates may vary by plan design, age,
12 geographic area, family size and wellness activities.

13 Q Please explain the revenue neutrality requirement as you
14 understand it in your role as lead health actuary as it
15 applies to the development and filing of rates for small
16 groups for existing plans and for new plans?

17 A Okay. When a carrier files a small group rate filing, they
18 have the ability apply for any of the allowable factors. The
19 revenue neutral requirement is that before and after they
20 apply for the factors, the overall projected revenue stay the
21 same. That's been for the existing plan because you're
22 talking about current demographic assumption using in this
23 kind of calculation. For the new plans, the carriers can
24 file any new plans any time. The revenue neutral requirement
25 or calculation does not apply to new plans.

1 Q Does your pre-filed direct testimony contain an example of
2 how this requirement works for existing plans?

3 A Yes. I believe it's . . . My pre-filed direct testimony, I
4 think it's on page 6, paragraph 15.

5 MR. HAMJE: And that, for the record, is
6 Exhibit S-51.

7 A I'd like to explain a little bit about this because the rate
8 reviewing process has never been a simple process. It's
9 usually very complicated. What I try to do in here is give
10 you the very simple illustrated examples and explain the idea
11 about revenue neutral requirement. It's just an illustrated
12 example.

13 Q (BY MR. HAMJE) Can you give an example to illustrate your
14 explanation about new plans?

15 A Yes. First I have to start explain, I want to make it clear,
16 when the carrier file new plans for the small group rate
17 filing, they basically have to start it from the existing
18 small group pool. And I believe the Commissioner is familiar
19 with what benefit activity is which just when you have this
20 new plan, you need to start with the existing small group
21 core. That's the regulation require.

22 Now, there is cases that the new plan has new futures
23 that not related to current existing small group pool. In
24 that case, it's actually the actuary's judgment that factor
25 in. The actuary uses other study or use the - his or her

1 actuary opinion to price these product.

2 So I'll give you a very simple example. Let's say the
3 carrier has a new small group plan that has a brand new
4 network type. In this case, an area factors is adding into
5 the existing area factors because it's associated with new
6 type of network. So theoretically, you can create a new
7 benefit plan that has exactly identical benefit components
8 with the existing small group plan. But the rates are
9 different because the area factors are different.

10 So in a case like this, you add more factors. But the
11 enrollment for the new plans are zero. So you don't need to
12 calculate revenue neutral calculation because there's no
13 weight.

14 Q And with respect to individual contract rates, what authority
15 does the OIC have?

16 A Well, the individual rate filings are for OIC's information
17 only and the Commissioner can only ask certain supporting
18 documentation prescribed in the statute. And the OIC or
19 Commissioner cannot disapprove or impede the implementation
20 of the rates.

21 Q What kind of supporting documentation may the Commissioner
22 request in terms of individual rate filings?

23 A There are four kinds of supporting documentation. And I like
24 to refer it to my pre-filed responsive testimony.

25 MR. HAMJE: For the record, that would be S-52.

1 A It's on page 2 of my pre-filed responsive testimony. The
2 first one is a description of the rate-making methodology.
3 This is usually a very simple description, sometimes less
4 than one page, just telling how the rates are projected. The
5 second one is actuarially determined estimate of incurred
6 claims, including the experience data, assumptions and
7 justifications.

8 Now, the statute does not prescribe how extensive the
9 experience data is. So it's based on the period the actuary
10 judgment presents the information. And most time I see is
11 just a one-page simple projection that include the experience
12 period incurred claim, earned premium, medical trend,
13 et cetera. But it's a very simple form that I usually see.

14 The third one is the percentage of premium attributable
15 in aggregate for the nonclaims cost. And this is - again,
16 this is a very simple statement such as the nonclaim cost
17 used in the projection is 20 percent or certain percentage.
18 And this sometimes is already included in the projections.
19 So that's just a very simple statement.

20 The last one is the certification by the actuary that
21 the anticipate loss ratio meets or exceeds 74 percent minus
22 premium taxes. And in Washington state, premium tax for
23 healthcare service contractor or HMO's are two percent. So
24 the actuary had to certify that the anticipate loss ratio
25 meets or exceeds the 72 percent loss ratio.

1 Q May the Commissioner question the reasonableness of data in
2 terms of individual rate filings?

3 A No. Because once the supporting documentation is in, the
4 Commissioner can only ask for those supporting documentation
5 information in connection with the filed individual rates.

6 MR. HAMJE: Thank you, Ms. Lee. That's all the
7 OIC Staff has.

8 MR. KELLY: Good morning, Ms. Lee. I just have a
9 couple of questions of you.

10

11 CROSS-EXAMINATION

12

13 BY MR. KELLY:

14 Q First I wanted to just ask a couple of questions about what
15 Mr. Staehlin had to say. I think he said that he had no
16 belief or expectation that Premera was going to create their
17 rate filings inappropriately. He thought - he had no reason
18 to think they were going to do something they shouldn't be
19 doing. Is that what you heard as well?

20 A Yes.

21 Q And I take it that you agree with that thought, too.

22 A I do.

23 Q And then he also said that a creation of rates was relatively
24 - a relatively complex effort and entails some actuarial
25 judgment.

1 A Yes.

2 Q And is that something that you would agree with as well?

3 A Yes, I do.

4 Q And then he also said that what is put into a rate filing is
5 what is expected but is not necessarily what the claims
6 experience will ultimately show for that rate filing. Is
7 that a fair way to describe that?

8 A Yes.

9 Q And is that something that is also your experience?

10 A Yes.

11 Q And then you were also present here I think on Monday morning
12 when Ms. Halvorson testified, were you not?

13 A Yes.

14 Q And you heard her testimony?

15 A Yes, I did.

16 Q You didn't have any problem with what she had to say, did
17 you?

18 A No. I think in general, I agree with her because she has
19 talking about revenue neutral requirement. She also talk
20 about the new plan, the weight is zero. So essentially it
21 doesn't apply to new plans.

22 Q Sounds like the actuaries are talking along the same lines
23 here. Let me ask you this: You have had occasion, over the
24 years that you have been the head actuary, to deal with
25 Ms. Halvorson, have you not?

1 A Yes, I believe so.

2 Q Okay. And --

3 A Most of the time I deal with her staff, yeah, because the
4 actuaries who file the rate filing reported to her.

5 Q And have you and your staff had a good professional
6 relationship dealing with Ms. Halvorson and her staff?

7 A Yes, we do.

8 Q And if you had a question about a new rate filing, would you
9 contact - either you directly contact Ms. Halvorson or
10 someone on your staff contact someone on Premera's staff to
11 discuss any questions that you had or so forth?

12 A Yes. We constantly do that.

13 Q Okay. And is it your experience that the Premera staff and
14 Ms. Halvorson have been helpful and responsive in providing
15 you with that information?

16 A Yes. That's my experience.

17 MR. KELLY: Okay. Thank you very much.

18 MR. COOPERSMITH: No questions from the
19 Intervenors, your Honor.

20 MR. HAMJE: No redirect.

21 JUDGE FINKLE: Thank you. Please step down.

22 MS. deLEON: Your Honor, the OIC Staff calls
23 Patrick Cantilo.

24 PATRICK CANTILO, having been first duly sworn by the
Judge, testified as follows:

25

1 DIRECT EXAMINATION

2

3 BY MS. deLEON:

4 Q Mr. Cantilo, could you please state your name for the record.

5 A Patrick Cantilo.

6 Q And where are you employed?

7 A I am a partner at the law firm of Cantilo & Bennett in
8 Austin, Texas.

9 Q And did you submit a curriculum vitae in this matter?

10 A Yes, I did.

11 Q And that is marked as Exhibit S-30. Could you please tell
12 the Commissioner about your educational background.

13 A I received a bachelor's degree in government and a law degree
14 from the University of Texas at Austin. I received my law
15 degree in 1980.

16 Q And could you please tell the Commissioner about your
17 professional background briefly.

18 A I started my law career as a staff attorney at the
19 liquidation division at what was then called the State Board
20 of Insurance in Texas. I was there for three years. I left
21 that to join a private law firm in Austin where I did
22 primarily insurance-related litigation, medical malpractice,
23 some antitrust, some other insurance matters.

24 I left that firm with two other gentlemen in the firm
25 and formed the first of several firms of which I've been a

1 managing and named partner. And since then I have
2 concentrated my practice in the representation of state
3 insurance regulators in a wide variety of matters.

4 Q Are you licensed to practice law in Washington state?

5 A I am not. I am only licensed in the state of Texas, although
6 I am admitted in a number of other federal courts.

7 Q What experience do you have relevant to this matter?

8 A In 1994, I was retained by the Virginia Bureau of Insurance
9 in connection with what was then the second largest Blue
10 Cross conversion, that of Trigon Blue Cross/Blue Shield. I
11 then worked on the conversion of what is now known as
12 RightChoice, which was the Missouri Blue Cross and Blue
13 Shield plan.

14 I was also retained in the mid eighties by the Colorado
15 Division of Insurance to represent it in connection with two
16 transactions. The initial transaction was a proposal by
17 Rocky Mountain Healthcare Corporation, which was the Blue
18 Cross and Blue Shield plan for at the time New Mexico, Nevada
19 and Colorado. That company wanted to do something very
20 similar to this one, that is to convert, go public, and
21 establish a foundation that would receive stock. That
22 transaction was abandoned when it became apparent to the
23 company that the IPO would not be viable. They then filed
24 another application to be acquired by Anthem. And our office
25 - our law office was again retained to represent the Colorado

1 Division of Insurance and lead the - what was called a
2 testimonial team in the evaluation of that transaction. That
3 transaction was approved.

4 I was also retained by the North Dakota Department of
5 Insurance in connection with a conversion of that plan from a
6 nonprofit nonstock corporation to a nonprofit mutual
7 corporation. It's a little bit of an unusual transaction.

8 I was retained by the National Association of Insurance
9 Commissioners to represent it as amicus curiae in litigation
10 commenced by the Attorney General in Kentucky arising from
11 the acquisition by Anthem of the Kentucky Blue Cross and Blue
12 Shield plan.

13 I was retained by the Kansas Insurance Department
14 initially in connection with a proposed conversion of the
15 Kansas Blue Cross and Blue Shield plan from a nonprofit
16 mutual insurance company to a for-profit insurance company,
17 still mutual. That resulted in litigation, as a result of
18 which the Sunflower Foundation was established in Kansas.
19 Later that company filed another application to be acquired
20 by Anthem, to demutualize and be acquired by Anthem.

21 And our law firm was again retained lead the
22 testimonial team in evaluating and presenting its case to the
23 Commissioner. That transaction was eventually turned down by
24 the Commissioner principally because she believed, based on
25 the record, that it would result in a rise in small group and

1 individual rates throughout Kansas and because it would
2 reduce the capital levels of the company. The decision was
3 appealed. The district court reversed the Commissioner. She
4 appealed, and she was affirmed by the Kansas Supreme Court in
5 what is probably one of the landmark decisions on Blue
6 Cross/Blue Shield conversion cases. That is cited in our
7 report.

8 I have also been retained by the Maryland Insurance
9 Administration in connection with a CareFirst conversion
10 about which you've heard here today.

11 I was retained by the Virginia Bureau of Insurance when
12 the now publicly-traded Trigon was then sought to be merged
13 into or acquired by WellPoint in 2002. And that transaction
14 was approved.

15 There may be others. I think I've mentioned all the
16 ones I remember.

17 Q Thank you. Have you prepared pre-filed direct and responsive
18 testimony in this case?

19 A Yes, I have.

20 Q And do you adopt that testimony?

21 A Yes, I do.

22 Q Did you also prepare five reports in this matter?

23 A Yes, we did.

24 Q Is Exhibit S-31 your firm's final report of October 27th,
25 2003?

1 A Yes, it is.

2 Q And Exhibit 32 is your firm's Executive Compensation Report
3 of November 26, 2003?

4 A Yes, it is.

5 Q Your firm also prepared a supplemental report of
6 February 27th, 2004?

7 A That's correct.

8 Q And an allocation opinion as of February 19th, 2004?

9 A That's correct.

10 Q And a firm's January 16th opinion regarding the Oregon
11 claims?

12 A That's correct.

13 MS. deLEON: Your Honor, at this time, Mr. Cantilo
14 has adopted his pre-filed direct and responsive testimony
15 that have been filed and served in this case. And the OIC
16 Staff moves to admit Exhibit S-30, which is Mr. Cantilo's
17 curriculum vitae; Exhibits S-43 and S-44, which are his
18 pre-filed direct and responsive testimony; Exhibits 31, 32,
19 33, 34 and 35 as his reports.

20 MR. MITCHELL: May I voir dire briefly?

21 JUDGE FINKLE: Yes.

22 //

23 //

24 //

25 //

VOIR DIRE EXAMINATION

BY MR. MITCHELL:

Q Mr. Cantilo, the exhibit which is S-32, the executive compensation report dated November 26th --

A Yes, sir.

Q -- 2003, am I correct in my understanding that that report has been superceded by your supplemental report filed in February of this year?

A For the most part. I think most of the issues raised in our report have been resolved in subsequent discussions with Premera.

MR. MITCHELL: No objection.

MR. MADDEN: No objection.

JUDGE FINKLE: Admitted.

DIRECT EXAMINATION

(continued)

BY BY MS. deLEON:

Q Mr. Cantilo, please describe your engagement by the OIC Staff in this matter?

A We were retained as the legal advisor to evaluate some questions specified in the personal services contract, which constitutes our engagement agreement, principally whether

1 fair market value would be transferred to the foundation in
2 the transaction, its impact on policy holders and insureds,
3 and whether it complied with applicable law.

4 Our engagement was later expanded to add consideration
5 of the parameters that the Commissioner may consider in the
6 allocation of consideration between Alaska and Washington,
7 consideration of an executive compensation program submitted
8 by Premera after the reports have been completed, and
9 consideration of a claim by the Oregon Attorney General to
10 some of the assets of Premera in connection with the
11 conversion.

12 Q Please describe how you performed the required analysis.

13 A We began by reviewing the Form A application first filed in
14 September of 2002. We met with staff at the OIC and the
15 other consultants retained by the OIC. We formulated data
16 requests and questions for the company and met initially with
17 Mr. Domeika and other company staff at Premera, and then over
18 time with many other people at Premera and advisors for
19 Premera. We received and evaluated volumes of data from
20 Premera and other sources regarding the conversion and, in a
21 series of meetings with the OIC consultants and the
22 consultants for the Alaska Division of Insurance, which I
23 will call the ADI, identified a variety of issues arising
24 from the conversion and posed questions to Premera and its
25 consultants regarding those issues.

1 Q During your discussions with Premera, did you suggest changes
2 to the proposed transactions?

3 A Yes. As has been my practice in other conversions and
4 comparable transactions that I haven't mentioned today in
5 other areas, early on we talk to the applicant about issues
6 that we thought might be either problematic under the review
7 standards or might make the transaction easier to approve.
8 However, the company advised us early on that their approach
9 would be to collect all the issues once the final reports
10 were submitted by the consultants and react only once at that
11 time rather than react seriatim over the review period.

12 Q And please explain how you arrived at your final report,
13 which is Exhibit S-31?

14 A After the process I described earlier, we prepared a draft
15 report of which copies were sent to Premera. On
16 October 15th, Premera responded to our draft report and the
17 draft report of all the other consultants in a letter to
18 which were attached seven exhibits, one for each area of
19 response. We took those comments into account and finalized
20 our report by the end of October, I believe October 27th.

21 Q Were you also asked to look at the executive compensation
22 issues?

23 A Yes. Premera had been unable to deliver to us by the time we
24 completed our reports its executive compensation package for
25 which we had asked for quite some time and many times. But

1 it did deliver that right after the reports were completed.

2 So the OIC Staff asked us to take a look at that.

3 We reviewed it and, as Mr. Mitchell suggested in his
4 voir dire question, we identified a number of issues with
5 that - with compensation package. But most of those have
6 since been resolved in discussions with Premera. There were
7 a few that were not resolved about which Mr. Nemerov
8 testified I guess two days ago now, and I have nothing to add
9 to those issues.

10 Q What did you do with respect to the proposed conversion after
11 your October report?

12 A Well, now that the reports were in, Premera was prepared to
13 have meaningful discussions with the regulators and their
14 consultants. So that commenced about the time of the
15 holidays, the Christmas holidays. And we had a pretty
16 intense set of discussions that spanned into the beginning of
17 this year, which were very productive. As a result of those
18 discussions, Premera agreed to make a number of significant
19 changes to the proposed transaction, which were embodied in
20 its revised or Amended Form A application filed on
21 February 5, if I remember correctly.

22 Q And did your firm provide a supplemental report regarding
23 those issues?

24 A Yes. Once the Amended Form A was submitted, we evaluated the
25 amended transaction and I think October 27th provided a

1 supplemental report that addressed the now amended
2 transaction.

3 Q And what did that report conclude?

4 A Our view was that the proposed transaction had improved
5 substantially as a result of the changes but still suffered
6 from a number of issues that we thought were material and
7 substantial. And we do not recommend that it be approved as
8 described in the Amended Form A.

9 Q Can you give me examples of those issues that remain
10 unresolved.

11 A One overriding issue in our mind is that as currently
12 structured, the transaction still will not deliver the fair
13 market value of the company to the two foundations. In
14 addition, I believe that aspects of the transaction and
15 aspects of the role of the Blue Cross and Blue Shield
16 Association have the effect of entrenching the current board
17 of directors in the company, which is not surprising given
18 that, as you've heard other testimony, there's some
19 substantial economic gain to be made from the transaction and
20 that indirectly will entrench management. That may or may
21 not have had an effect on the deliberations about what other
22 transactions were possible. And I can go into more detail
23 about that later.

24 We have concerns about restrictions on the ability of
25 the foundations to exercise voting rights as the largest

1 stockholders of the company.

2 And we have concerns about the potential impact of the
3 transaction on the company's insureds and insurance-buying
4 public, although those concerns are concerns about which we
5 were informed by the other OIC consultants and about which
6 you have already had comprehensive testimony, primarily by
7 PricewaterhouseCoopers and by Dr. Leffler.

8 Q Did you have some concern regarding guarantees?

9 A Yes. The company, Premera, agreed to provide guarantees to
10 Washington and Alaska, sometimes referred to as claims
11 guarantees, but there are material differences between the
12 guarantees offered to Alaska and to Washington. The
13 guarantees offered to Alaska not only commit the parent
14 company, New Premera, to stand behind the claims obligation
15 of the Alaska plan, but in the event the Alaska plan fails
16 for whatever reason, they commit to replace the coverage of
17 Alaska insureds.

18 In the case of Washington, surprisingly, they're not
19 offering the replacement of coverage guarantee. They're only
20 offering the claims guarantee. This is a matter that we have
21 brought to their attention. But so far there has been no
22 change. The response, as I understand it, is that the
23 Washington guarantee is modeled after that portion of the
24 Blue Cross and Blue Shield Association licensing agreement
25 that pertains to what is called there larger-controlled

1 affiliates, whereas the Alaska guarantee is based on the
2 smaller-controlled affiliate sections of the licensing
3 agreement.

4 That may be. But in our judgment, nothing prevents
5 Premera from agreeing to provide the same guarantee to
6 Washington as it does to Alaska, even though that may not be
7 the floor required by the Blue Cross and Blue Shield
8 Association.

9 Q Didn't Mr. Marquardt, in his testimony earlier, provide
10 verbal assurances that they would issue the same guarantee to
11 Washington?

12 A I heard him say they would stand behind the company. That
13 doesn't seem to me to be nearly sufficiently specific for the
14 Commissioner to be able to rely upon it. But if what they
15 mean by that is that they will provide the same guarantee,
16 then our concern about that issue is eliminated.

17 Q Are there any other unresolved issues?

18 A Well, there are the issues of the fair market value transfer;
19 the issue of the economic impact; the issue of the
20 restrictions placed on the foundations' ability to exercise
21 their vote and trade their stock, which are related to the
22 fair market value transfer issue; and then issues about the
23 possibility that the transaction entrenches management.

24 Q And are these encompassed in your reports?

25 A Yes. Those and other issues that are not as high in level of

1 importance are in the report.

2 Q Do your report contain the conclusions of other consultants?

3 A We refer to the work of the other consultants. But our
4 report cannot be viewed as a substitute for the reports of
5 the other consultants. In fact, our report clearly says it
6 needs to be read in conjunction with the reports of the other
7 consultants.

8 Q Were you asked to consider the issues regarding the
9 allocation of stock between Washington and Alaska?

10 A Yes, we were, and concluded three basic things. With respect
11 to LifeWise of Washington, which is a nonprofit company, we
12 believe the entire value of that company ought to be
13 attributed to Washington in any allocation exercise. With
14 respect to the for-profit subsidiaries, including Calypso, we
15 feel they ought to be treated like any investment of Premera,
16 just like stocks and bonds held by the company and the value
17 allocated in the same way as the ultimate allocation
18 percentage for all the other assets.

19 Most importantly, we believe that the law gives the
20 Commissioner latitude to select from a range of allocation
21 percentages rather than require that he have before him a
22 precise allocation percentage point.

23 Q Are you aware of a claim by the Oregon Attorney General to
24 Premera's assets?

25 A Yes. We were made aware of that claim by Mr. Fallis of the

1 Attorney General's office. He provided the letter setting
2 out the claim that had been prepared by the Oregon Attorney
3 General's Office. We evaluated that claim, researched the
4 underlying issues. And in our judgment - and we so reported
5 - the claim did not have sufficient merit to justify
6 delivering a percentage of the value of Premera to the State
7 of Oregon.

8 Q Mr. Cantilo, have you acted as an advocate instead of an
9 expert in this matter?

10 A Well, I was surprised to see in the report of Premera that
11 that's how they perceive my role. I, as you probably know,
12 have not appeared in any hearings or written any briefs or
13 filed any papers or taken any depositions or defended
14 depositions, so I have not acted as an advocate in that
15 sense. I suppose to the extent that our report articulates
16 our views and probably does so with somewhat strong language
17 where we think it's warranted, that is advocacy in some
18 respects. And only in that sense can I say that we were
19 acting as advocates.

20 Q What is your overall conclusion about the proposed
21 transaction?

22 A As I said earlier, I think it's a much improved transaction.
23 I think there are still problems with it. It is our view
24 that those problems, while they might justify disapproval of
25 the transaction as a whole, could be remedied by the company

1 if it elected to do so in a way that might make the
2 transaction approvable by the Commissioner.

3 Q I understand that one of your concerns was the transfer of
4 fair market value.

5 A That is one of the overriding issues. That's a somewhat
6 complicated issue. In Washington, unlike some of the other
7 states in which I have worked on these conversions, there is
8 not a specific conversion statute. What the company elected
9 to do was to dissolve and form a new company to which it
10 would transfer its assets. Now, that triggers both the
11 Holding Company Act and the Nonprofit Mutual and
12 Miscellaneous Corporation Act. Throughout the application
13 the company filed, there are a number of references to its
14 commitment to convey 100 percent of its stock or 100 percent
15 of its assets to the foundations.

16 Q Do you have examples of these on a slide?

17 A I do. If I can get the projector to work, I can maybe put
18 them on the screen. These come from the application itself,
19 the Form A application. What I have here - and I hope
20 they're legible are excerpts from pages 4 and 9 of the Form A
21 application. And as you can see, on page 4, they say that
22 100 percent of the capital stock of New Premera will go to
23 the foundations, which amounts to direct or indirect control
24 of the acquired company, which we read as the entire company.
25 On page 9 as you see, they say that the Washington/Alaska

1 foundations will receive 100 percent initial ownership of New
2 Premera. And then on page 17, they say that they will
3 dissolve and distribute 100 percent of the assets of the
4 company to the foundations.

5 Now, over the time that we reviewed the transaction, I
6 think all the consultants and regulators assumed that this
7 was a commitment to convey 100 percent of the fair market
8 value of the enterprise. And that issue did not, in our
9 minds, become a giant issue until there was response to our
10 final report.

11 Earlier, as we began the review of the transaction,
12 there had been a decision made by the review team that some
13 of the issues raised by the original application were so
14 substantial that it would be helpful to Premera to convey to
15 them what we called the structural issues. And
16 representatives of the two regulatory groups met with Premera
17 and advised them of some of those structural issues. And one
18 - I think may even have been the first one on the list - was
19 that we wanted assurances that we were reading these
20 documents correctly, that that meant conveyance of the fair
21 market value of the enterprise.

22 As I said earlier, initially Premera's response was,
23 "We're not going to respond to criticisms or make changes or
24 do any of those kinds of things until the final reports are
25 in." Then the final reports did come in. And in our report,

1 we say we're not addressing the question of whether the
2 company has a charitable obligation or an obligation to
3 convey 100 percent of its fair market value because we
4 believe there is agreement among all the parties that that's
5 what Premera is going to do and what it's required to do.

6 And the response by Premera, which I think I also have
7 in a slide . . . I do. This is Exhibit 7, page 3 of
8 Exhibit S-86, which is already in the record. And I believe
9 Mr. Hamje asked Mr. Steel about this section. But as you can
10 see in that second bullet point, they say that Premera has
11 never agreed to this proposition.

12 But they go on to say Premera has agreed only that it
13 will transfer 100 percent of its stock to the foundation
14 shareholder, which represents the fair market value of the
15 company. So although it may be somewhat confusing, I think
16 the record is clear. The company clearly has told anyone who
17 will listen that it's going to convey 100 percent of its
18 market value. We hadn't been engaged to look at that issue
19 and didn't do any extensive legal research on the subject.

20 I will note though that notwithstanding everything
21 we've heard in the last few days about the absence of an
22 obligation to create a charitable foundation or the fact that
23 the company is not a charitable organization, the structure
24 it elected to pursue to convert compels the same result. The
25 Nonprofit Corporation Act that applies to the company

1 requires that when the company dissolves, after it pay its
2 debts, it distribute the rest of its assets in accordance
3 with its articles. And this is section 265 of the Act.

4 And if you look at Premera's articles, it clearly
5 requires that after it pay its debts, the balance be
6 distributed to one or more nonprofit corporations or
7 nonprofit entities. Now, since the successor is going to be
8 a for-profit entity, New Premera clearly can't walk away with
9 the assets. So I think the logical interpretation of that
10 statute and those articles is that they have to put them in
11 some nonprofit entities. And they've chosen to do that.

12 I suppose technically what they could do or maybe what
13 they should do is when they dissolve, take all their desks,
14 their computers, their pencils, their contract rights, their
15 books of business, their intellectual property rights and
16 convey that, because those are the assets of the company,
17 convey that to the foundations. Of course, if they did that,
18 they would be out of business.

19 Of course, what they've chosen to do is convert all of
20 those assets into stock by creating the new company and
21 giving the stock to the new company. All that's fine. I
22 think all that works, provided that the stock clearly conveys
23 everything. The problem here is that the transaction imposes
24 on that stock an array of restrictions and conditions as a
25 result of which, in our judgment and the judgment of other

1 advisors of the OIC and you probably will hear eventually the
2 ADI, the value becomes less than 100 percent of the fair
3 market value of the enterprise.

4 Q What are the restrictions that concern you?

5 A They fall principally in three categories. There are
6 restrictions on the ability of the foundation to vote. There
7 are restrictions on the ability of the foundations to be
8 represented on the board of Premera, of which it will be the
9 largest stockholder. And there are restrictions on the
10 ability of the foundation to trade the stock that it will
11 receive.

12 Q When you talk about the ability to trade, is that the
13 divestiture schedule?

14 A It is. The Blue Cross and Blue Shield Association licenses
15 the name of - the use of the name and mark throughout the
16 country. And there is a lengthy and almost incomprehensible
17 licensing agreement into which all the plans are required to
18 enter. It contains at section 9 a provision that if a
19 company becomes for-profit, it will lose its license unless
20 once it becomes for-profit less than five percent of its
21 stock is owned by an individual or 10 percent if the
22 individual is an institutional investor.

23 It also . . . And I can talk more about this, as you
24 may detect throughout my comments that I have somewhat strong
25 feelings about this subject. There's also a provision that

1 the preconversion board has to remain in control
2 post-conversion. Those are the two conditions of the license
3 that apply to conversions.

4 When plans beginning with WellPoint and Trigon in '94,
5 when the rules were first changed by the association to
6 permit for-profit operation and ever since then, when plans
7 approached the association and said, "We want to convert;
8 will you waive these restrictions so that I can give all my
9 stock to a foundation, as the mean Attorney General or
10 Commissioner is requiring;" the association has responded,
11 "Yes, we will waive these conditions, but we will impose new
12 conditions as a condition to the waiver." And those are the
13 conditions about which you have heard so much during the last
14 few days that are the divestiture schedule and a variety of
15 other things.

16 What's somewhat frustrating and mystifying about these
17 conditions is that they're not written down anywhere. You
18 can't go to the licensing agreement or the Blue Cross/Blue
19 Shield Association website or anywhere else and get the list
20 of the conditions. The plan approaches the association,
21 comes away with a list of conditions, and then reports that
22 back.

23 And that's what's happened here. We were told about
24 the conditions by Premera. We don't have any official
25 communication from anyone, nor is there any statutory basis

1 or other legal foundation for the conditions. But one of the
2 conditions is the divestiture schedule. It requires that the
3 foundation sell down to 20 percent of its stockholding by
4 year one, 50 percent by year three, 20 percent by year five
5 and five percent by year 10. Now, that may not seem like an
6 unreasonable schedule. But the problem is that it deprives
7 the foundation of the ability to make an enlightened decision
8 about when to sell the stock into a favorable market. We've
9 had a good market in the past, as Mr. Alderson Smith
10 testified. But none of us here can guarantee it - and I
11 think the last few days can give us a glimpse of that - that
12 the good markets will continue if the war in Iraq or, heaven
13 forbid, another 9/11 episode or something like that were to
14 occur during the sell-down period, the foundation will be
15 compelled to realize substantial losses in the value of their
16 stock.

17 Q How does the unallocated shares escrow agreement relate to
18 this issue?

19 A The unallocated shares escrow agreement, which in theory was
20 a document suggested by Premera I think out of good intent to
21 resolve the issue arising from Washington and Alaska not
22 having themselves resolved the allocation, has a provision
23 that has nothing to do with that in it but which aggravates
24 what I've just described. There is a provision in that
25 agreement that requires the foundation to participate in the

1 IPO by selling not less than 10 percent of its stock. So A,
2 that accelerates the divestiture schedule that I've just
3 described. B, it requires the foundation to sell discounted
4 stock because to make the IPO successful . . . This is not a
5 criticism. This is what happens in every IPO in corporate
6 America. To make it successful, as Mr. Koplovitz explained,
7 the hypothetical value of the stock is artificially reduced,
8 typically by as much as 15 percent or more, to make it
9 attractive in comparison with the stock already being traded
10 in the market for established companies.

11 It also creates a psychological advantage. Investors
12 know that they're buying cheap stock so they know the stock
13 will go up. And everyone likes to see IPO's do well. We all
14 love to see the stock go out at 30 and go to 45. And the one
15 way you achieve that is not by having a magical company but
16 by underselling the stock to begin with.

17 That's all great. But if we're being compelled - if
18 the foundation is being compelled to put 10 percent of its
19 stake of the company at that discount, that's bad for the
20 foundation. The foundation may want to sell some of its
21 stock to realize some cash for its operations, but I think
22 the board of the foundation ought to have the latitude to
23 decide how much of its stock it wants to sell at that
24 discount.

25 Q Could you also explain the relationship with the two

1 foundations and the combined divestiture schedule.

2 A Certainly. The conversion, of course, has to satisfy the
3 obligations that arise both in Washington and Alaska. And
4 the way that is going to be done is by having a foundation in
5 each of the two states.

6 Originally, as first filed, the transaction suggested
7 the creation of a foundation shareholder, to which I think we
8 saw reference in one of the slides, which would receive the
9 stock on behalf of both foundations, sell the stock on behalf
10 of both foundations, and then distribute the proceeds to a
11 charitable organization in each of the two states. So there
12 would be one foundation shareholder, two charitable
13 organizations.

14 From the very beginning, that structure appeared to the
15 OIC's consultants and advisors as unnecessarily complex and
16 raising substantial and troublesome issues about the
17 allocation between the two states as well as the combination
18 of divestiture schedules and other issues. So we asked early
19 on that the foundation shareholder be eliminated altogether
20 and we simply have the two foundations.

21 As the application was amended in February, that
22 finally was adopted as part of the change in the transaction
23 by Premera. So we now do have two foundations, one in
24 Washington and one in Alaska.

25 But to our great disappointment, Premera wants to

1 treat, ostensibly at the insistence of the Blue Cross and
2 Blue Shield Association, the two foundations as if they were
3 a shingle shareholder. And that's a problem. That's a
4 problem because the divestiture schedule that I described
5 earlier, selling down 80, 50, 20 and five, will now apply in
6 combination to both foundations. And what makes that worse
7 is that the way that agreement is drafted, if one of the
8 foundations fails to sell its portion, for whatever reason,
9 the other has to make up for it and sell more so that in the
10 aggregate, they've gone down to the threshold.

11 There are other problems with the treatment of the two
12 foundations as one. Board representation has been a very
13 hotly contested issue. Now, most recently they've agreed
14 finally to give each of the two foundations a separate board
15 representative. So that issue has been resolved. But one
16 that has not been resolved is the free vote issue. The
17 association restrictions apply to anyone who holds 5 percent
18 or more of the stock. So from the beginning, we asked
19 Premera to agree that five percent less one share, in other
20 words, just the minimum, the five percent, of the stock
21 received by the foundations be completely free voting stock
22 because that would not violate the Blue Cross licensing
23 agreement. And Premera agreed to do so, which was good.

24 Unfortunately, as the two foundations were split,
25 they've combined the five percent. So it's not that each

1 state will get five percent free voting stock. It's that the
2 two states together will get five percent free voting stock.

3 The combination of the divestiture schedule and the
4 five percent free vote allotment does not, to me, have any
5 rational basis. I don't see how anyone can, in good faith,
6 articulate the position that Washington and Alaska are one
7 entity. The two foundations will be governed by separate
8 boards, appointed by separate public officials, with separate
9 missions and with separate constituencies. They may have
10 completely different interests in how quickly they monetize
11 their stock and how they use it. And I don't understand to
12 this day how the association or Premera can believe that it's
13 reasonable to treat the two as one.

14 Q But if these restrictions are required by the Blue Cross/Blue
15 Shield Association and Premera wants to preserve the mark,
16 then aren't these restrictions necessary?

17 A That's a difficult question. I understand that there's a
18 great deal of value to the Blue Cross and Blue Shield license
19 and I'm not debating that for one second. The challenge for
20 the Commissioner, as it has been for regulators throughout
21 the country, is the association is really the group of
22 Mr. Barlow and his associates. The association is managed
23 by the CEO's of all the Blue Cross and Blue Shields plans,
24 largest of whom are the two publicly-traded plans, Anthem and
25 WellPoint, which will soon merge into the second largest

1 health insurance in the country. So that group of CEO's gets
2 together and puts these rules together and then they are
3 presented to regulators throughout the country as
4 restrictions and conditions and qualifications that have to
5 govern the way in which regulators approve these
6 transactions.

7 To be sure, the licensing agreement does have that five
8 percent/10 percent vote - rather ownership, stock ownership,
9 restriction. And it certainly has a provision that
10 entrenches the board because it requires the preconversion
11 board to remain in control after the conversion. Does that
12 mean that the Commissioner is bound to accept terms that
13 comply with those rules? I think that's an open question. I
14 think the Commissioner can certainly tell any Blue Cross plan
15 in any of these states, "Look it, you want to convert. You
16 can go persuade your friends in the association that the
17 price of conversion in this state is reasonable conditions,
18 not dictatorial conditions," in which case I presume the
19 company will have to elect between converting or not
20 converting or persuading its friends at the association that
21 to convert, they have to be more lenient or more open-minded
22 about the conditions they impose on the license.

23 Q Now, your report raises an issue about the board's failure to
24 consider a sale. What was that issue?

25 A The records produced to us by Premera demonstrate that the

1 board consider an array of options to raise capital. And
2 we've heard about that. Surplus notes, organic growth, of
3 course the IPO, but also potentially merger and sale. In our
4 judgment, the option of merging with another carrier in or
5 out of state or selling the company to another carrier was
6 not given very serious consideration. And I think we've had
7 candid explanations about that here. The board was concerned
8 that any merger or sale would have entailed the loss of
9 autonomy for the current board. Now we hear, as we've heard
10 in other states, that the loss of autonomy translates into
11 poor service for members or some other disadvantages for
12 someone other than management.

13 I think Premera's expert witness, Ms. Novak, was very
14 candid about that and very informative. When we asked her
15 that question - I say we - here I am advocating - when
16 counsel for the OIC posed that question, she conceded
17 candidly that it was primarily disadvantageous for management
18 because they would lose control of the company. She conceded
19 that other acquired companies have done better after being
20 merged or acquired than before. And that has certainly been
21 my experience.

22 The Colorado plan, to which I referred earlier, before
23 it was acquired by Anthem, was a poorly performing, low
24 market share, poorly perceived plan. And since then it has
25 turned around. It's now a much more successful plan getting

1 much better ratings and is much better perceived by the
2 market.

3 And that experience has been true from all the evidence
4 I've seen, in Main where it required another plan, in
5 Connecticut, in Missouri where we now have the WellPoint
6 plan, and a variety of other markets. So I'm sure one can
7 find horror stories for the other case, but it's far from a
8 foregone conclusion that every merger or acquisition turns
9 out to be bad for policy holders, insureds and the
10 insurance-buying public. I do think that surveys would show
11 it's bad for management and the board because they typically
12 do lose control. They may cash out, but they will not be in
13 control for the long-term.

14 Q Are you saying that the commissioners should force Premera to
15 sell its stock?

16 A Not at all. I think perhaps an IPO is a perfectly defensible
17 position. I'm saying two things. One is that one of the
18 things that we were asked to evaluate is the due diligence by
19 the board in deciding to propose this transaction. And we
20 have that one concern. The board may not have paid enough
21 attention to the prospect of a sale or merger.

22 And two, as I said earlier, I am concerned that the
23 transaction is structured so as to entrench the board and
24 management. And I think rejection of the sale and merger
25 option was motivated by that consideration.

1 Q You also said that you had concerns regarding the
2 implementation of the transaction. What are they?

3 A There are principally two areas of concern. One has to do
4 with timing and one has to do with undertakings. By timing,
5 I mean as it's currently structured, the company will have
6 12 months following the Commissioner's order within which to
7 complete the IPO. And it can come to the Commissioner for
8 extensions of that time if justified.

9 Premera has added a provision that give it automatic
10 three-month extensions, up to two of them, if there's
11 litigation pending. In our judgment, if pending litigation
12 creates a compelling reason for extension, then Premera ought
13 to come to the Commissioner and explain that and ask for the
14 extension. Otherwise it should close at the - at the
15 specified time.

16 As to undertakings, again, they fall into two
17 categories. One has to do with the economic assurances. And
18 those have been explained at length by PricewaterhouseCoopers
19 so I won't repeat that. Summarize only that they should be
20 extended beyond the currently proposed two-year period. The
21 other has to do with what is called the bring down
22 certificate. That is a set of representations that Premera
23 has to make following the conclusion of this hearing
24 proceeding but before the effective date so as to assure the
25 commissioner that there have been no material adverse changes

1 during the ensuing period following the Commissioner's
2 approval as the result of which he might have rendered a
3 different decision.

4 There are some aspects of that that were hotly
5 negotiated. And there's one that I believe remains in
6 contention. There may be more but I can think of one now.
7 We had asked that Premera advise us of a change of 25 percent
8 or more in its RBC during that period. And Premera has only
9 been willing to advise us of changes of 50 percent or more.
10 And that to me is mysterious because we're not asking them to
11 do anything other than tell us. If there's been a change,
12 tell us that there's been a change of more than 25 percent.
13 That doesn't seem that challenging.

14 There may be other of these bring-down certificate
15 issues in the Blackstone reports and the
16 PricewaterhouseCoopers reports. But those are the areas to
17 which I refer in general.

18 Q Do you have any other issues which you'd like to bring up at
19 this time?

20 A No. I think I've probably said quite enough. And I've said
21 it very fast.

22 MS. deLEON: Your Honor, that's all we have.

23 JUDGE FINKLE: Unless you're going to be quicker
24 than I expect, we'll see you at 1:30.

25 (Lunch recess.)

1 JUDGE FINKLE: Ready when you are.

2
3 CROSS-EXAMINATION
4

5 BY MR. MITCHELL:

6 Q Thank you. Good afternoon, Mr. Cantilo.

7 A Good afternoon, Mr. Mitchell.

8 Q Let me start by asking you a question about timing, if I
9 might.

10 A Yes, sir.

11 Q Specifically with respect to the duplicate foundation rights
12 and the position of the OIC Staff's consultants on the
13 question of whether there should be a single foundation
14 shareholder or two foundation shareholders. As late as
15 December 2nd, 2003, you had not decided whether it would be
16 better to have two foundations or one foundation. Is that
17 not true?

18 A My recollection, although I'm not the tax advisor, was that
19 as early as February 2003, we had concluded that the proposed
20 structure with the foundation shareshoulder for both states
21 and then separate charitable organizations, one for each
22 state, was suboptimal from nontax reasons. There was
23 consideration at that time, as you probably recall, of
24 actually having two foundation shareholders and two
25 charitable organizations. And then over the ensuing months,

1 I think our own tax advisors concluded that we could probably
2 accomplish the role of obtaining 501(c)(4) qualification with
3 a single entity in each state.

4 So I think I would describe it as an evolutionary
5 process beginning with the Premera proposal of one foundation
6 shareholder and two charitable organizations, to
7 consideration and debate about two foundation shareholders
8 and two charitable organizations, to what we ultimately
9 concluded would be the optimal solution which is a single
10 foundation to fulfill both functions, one for each state.
11 And I think that issue was finally decided among all the
12 parties when you filed your amended application.

13 MR. MITCHELL: Your Honor, will you please ask -
14 instruct the witness to answer the question that is posed to
15 him. My question --

16 JUDGE FINKLE: Why don't you continue. We're a
17 couple questions short of that instruction.

18 Q (BY MR. MITCHELL) Mr. Cantilo, as you sat in your deposition
19 on December 2nd of last year and I asked you whether you
20 would recommend the creation of two foundations in place of
21 the one proposed by Premera, did you not tell me that at that
22 point, you did not have enough information to determine
23 whether there would be enough gained by that proposal to
24 offset the potential disadvantages of doing so?

25 A I don't have a specific recollection. But that's entirely

1 possible. That would have been during the period we were
2 still evaluating it.

3 Q So the notion of having two foundations which was initially
4 suggested by Alaska, was endorsed by the OIC Staff's
5 consultants only in January of this year; is that right?

6 A Well, no. My recollection is, as I said earlier, I think,
7 what Alaska had recommended was --

8 Q Sir, I think a simple no would be sufficient.

9 A I'm sorry. I was trying to make it clear.

10 Q Now, you believe, do you not, that the restrictions of the
11 Blue Cross/Blue Shield Association are part of a legal
12 landscape of this case?

13 A Could you define for me the term legal landscape of this
14 case?

15 Q Well, I think I might ask you to do so since it's your
16 phrase.

17 A Well, if I used it, what I would have meant by that is that
18 Premera had entered into a contractual arrangement with the
19 association through the licensing agreement in which it had
20 agreed to abide by the five percent slash 10 percent slash
21 20 percent rule in the event of conversion and the provision
22 regarding changes in the board so that the same board was
23 pre and post-conversion.

24 Q Is it not the case, Mr. Cantilo, that while we might not like
25 the Blue Cross/Blue Shield Association restrictions, we have

1 to accept them if Premera is to retain the Blue marks?

2 A Not in my view. May I --

3 Q One moment please.

4 A I would like to clarify my answer, however, because I want to
5 make sure I'm answering the question you asked. If by then
6 you mean only the restriction on shareholding and on
7 composition of the board before and after, that is in the
8 licensing agreement. I think all the other conditions are
9 negotiable.

10 MR. MITCHELL: Your Honor. (Handing document.)

11 Q (BY MR. MITCHELL) Mr. Cantilo, do you recall writing a
12 memorandum to Mr. Fallis earlier in your work on this matter
13 in which you advised him, quote, "Unless and until we are
14 disposed and able to compel the Blue Cross/Blue Shield
15 Association to waive or eliminate these restrictions and
16 conditions" - and then you underscored the following passage
17 - "without impairing Premera's right to the name and mark, we
18 should probably treat them as a given on our landscape"? Do
19 you recall writing that?

20 A I'm sure I felt it. I don't recall writing it. But it
21 sounds like something I would have written.

22 MS. HAMBURGER: Could counsel let us know where
23 he's reading from?

24 MR. MITCHELL: It's the March 22nd deposition,
25 page 316.

1 Q (BY MR. MITCHELL) And do you recall, Mr. Cantilo, that in
2 March of this year, I asked you whether that was still your
3 view?

4 A You asked me a lot of questions, Mr. Mitchell. I don't
5 recall you asking me that question.

6 Q Do you recall, Mr. Cantilo, that you told me that there are
7 probably some restrictions that it would be exceedingly
8 difficult if not impossible to have waived or modified by the
9 association and, upon a conclusion by the Commissioner that
10 the preservation of the name and mark is of greater value
11 than the elimination of those restrictions, those should be
12 viewed as part of the landscape?

13 A I think that's true. Whether I said it then or not, I do
14 think that's true.

15 Q Now, with respect to the duplicate foundation rights that
16 were proposed by the state's consultants in January, you are
17 aware, are you not, that Premera undertook immediate steps to
18 see if those things might be acceptable? It convened a
19 special board meeting. It contacted the association. It
20 tried to set up a meeting with the association. And it
21 invited the state's consultants to accompany it in speaking
22 to the association. Is that not true?

23 A Are you talking about earlier this year?

24 Q I am.

25 A I recall Premera reporting all that.

1 Q And the state's consultants, including yourself, declined the
2 invitation to participate in those discussions, did you not?

3 A I did not have the authority to make the decision. But I
4 recommended against it.

5 Q And with respect to the position of the association, I think
6 you suggested that it was unknown. In fact, the position of
7 the association is set forth in a letter that was attached to
8 the pre-filed direct testimony of Mr. Barlow. Is that not
9 true?

10 A I think that's true.

11 Q And with respect to the position of the association earlier,
12 you were well aware from your work in other conversions as to
13 the position that the association had taken in those matters,
14 were you not?

15 A I was aware that the association had taken specific positions
16 in each transaction, but they were not the same position in
17 every transaction.

18 Q With respect to these restrictions, Mr. Cantilo, that are
19 part of the landscape that we have by dint of the Blue
20 Cross/Blue Shield Association's requirements, would you not
21 agree with me that they may actually enhance the value of the
22 shares that are so restricted?

23 A You would have to be specific about which restriction. My
24 view is that most do not have that effect.

25 Q But some do? Would you agree with that?

1 A I think that there may be some lock-up or divestiture kinds
2 of provisions that could help during the IPO process.

3 Q Would you agree with me, Mr. Cantilo, that the judgment of
4 the investment bankers on that particular question might be
5 superior to your own?

6 A It might be.

7 Q I want you to assume for a moment, Mr. Cantilo, that instead
8 of having the assets of a health insurance company, Premera
9 had as its asset - principal asset a house on a lot that had
10 a restrictive covenant and an easement. I want you to assume
11 further that Premera decided to dissolve and, pursuant to the
12 requirements of its articles of incorporation, to distribute
13 that asset to a nonprofit corporation. Will you assume that
14 for me, please?

15 A Yes.

16 Q Is it your position, Mr. Cantilo, that the nonprofit
17 organization that received that house and lot could take the
18 house and lot without the easement and without the covenants?

19 A I think that depends on the facts. I suppose you could
20 assume that there was no way of negotiating those away, in
21 which case the answer is yes. If you could negotiate them
22 away, the answer is no.

23 Q Do you believe that the recipient of that gift in that case,
24 Mr. Cantilo, would have the legal right to demand the
25 delivery of the house and lot without the covenant and

1 without the easement?

2 A Mr. Mitchell, you're not giving me nearly enough facts to
3 answer that question. That would call for a lot of
4 speculation.

5 Q Well, let's then turn to what I understand to be the initial
6 scope of your responsibilities in this matter, Mr. Cantilo.
7 Now, as I understand it, your reports review Premera's Form A
8 proposal and the information provided by Blackstone and PwC
9 for the purpose of determining how the proposal stacks up
10 against the criteria for decision established by the Holding
11 Company Act; is that correct?

12 A That was one of our assignments.

13 Q Now, your reports do not attempt to summarize all of the
14 information in the other consultants' reports, do they?

15 A No, sir, they do not.

16 Q And I believe, as you testified this morning and as your
17 reports themselves say, they must be read in conjunction with
18 the other consultants' findings; is that right?

19 A That is correct.

20 Q To read the Cantilo & Bennett reports in isolation could lead
21 to an incorrect conclusion, could it not?

22 A Certainly in parts of the report, that would be the case.

23 Q And you do not regard your reports as deserving any more
24 weight than say the analysis performed by Blackstone in this
25 matter, do you?

1 A My view of what weight they should be given is that the
2 Commissioner makes that determination.

3 Q Let's then focus upon the holding company's criteria to be
4 applied in this proceeding if we might, Mr. Cantilo. And for
5 purposes of this inquiry, I'm going to refer to the OIC
6 Staff's prehearing memorandum regarding hearing issues.

7 MR. MITCHELL: May I approach?

8 JUDGE FINKLE: Yes.

9 Q (BY MR. MITCHELL) Okay. First of all, you agree, do you
10 not, Mr. Cantilo, that Premera's Amended Form A proposal is
11 to be reviewed under the criteria set forth in RCW 31(b)015
12 and RCW 48.31(c)030?

13 A Yes, sir.

14 Q And I think there's a typo on this thing, which we will fix.
15 (Complying.) Now, the first of these criteria asks whether,
16 after the change in control, New Premera will be able to
17 satisfy the requirements for registration as a health
18 carrier; is that right?

19 A That's my understanding.

20 Q There is no question in this case that New Premera will be
21 able to satisfy those requirements, is there?

22 A Our opinion is that it will satisfy those requirements.

23 Q Okay. So I'm going to write "no" in the margin. Now, the
24 second criteria asks whether the conversion will
25 substantially lessen competition or tend to create a monopoly

1 in the health coverage business; is that right?

2 A Yes.

3 Q And in this case, there's no evidence to suggest that the
4 conversion will have such an effect, is there?

5 A Well, I think that's an issue for the Commissioner to
6 determine. There has been a lot of evidence about the impact
7 of a transaction on the market. Whether you characterize
8 that evidence as leading to the conclusion that it will
9 reduce a reduction in competition is a matter that I don't
10 believe I'm qualified to opine on.

11 Q Didn't Dr. Leffler confirm in his testimony yesterday that
12 there will be no impact on the structure of the market for
13 healthcare coverage as a result of the conversion
14 transaction?

15 A I'm afraid I wasn't listening to all of Dr. Leffler's
16 testimony. That may be what he said.

17 Q And didn't you conclude in your report that there is no
18 substantial evidence to suggest that the conversion will have
19 the effect such as that set forth in this criteria?

20 A We made that observation.

21 Q And didn't you, in fact, confirm that in your deposition
22 testimony when I spoke with you on March 10th?

23 A I believe that's true.

24 Q So insofar as you know, and insofar as we have heard from
25 Dr. Leffler, the answer to this question is also no, is it

1 not?

2 A Well, except as I explained in answer to your first question.

3 Q Well, didn't you conclude in your report, Mr. Cantilo, that
4 it would be rank speculation to suggest that there would be
5 any such impact on competition from the conversion?

6 A If I recall the reference, it had to do with whether the
7 company would use its additional capital resulting from the
8 conversion to create an anticompetitive effect.

9 Q I think that's right, Mr. Cantilo. You got to that point
10 because you concluded that immediately as a result of the
11 conversion, there would be no impact, no competitive injury.
12 And then you were concerned about whether there might be
13 longer term some competitive injury; isn't that right?

14 A I think that's right. I think that's a section of the report
15 that deals with whether market share increases as a result of
16 that transaction.

17 Q And it deals specifically with this criterion, does it not?

18 A That is relative to this criterion.

19 Q So you concluded that there would be no immediate impact on
20 the market. And you concluded that any long-term impact
21 would be purely speculative; is that right?

22 A No.

23 MR. MITCHELL: May I approach?

24 JUDGE FINKLE: Yes.

25 Q (BY MR. MITCHELL) Do you recall, Mr. Cantilo, being asked

1 whether or not you concluded that there does not seem to be
2 an antitrust violation as a result of the transaction?

3 A Yes.

4 Q And you answered that that there does not, in fact, seem to
5 be an antitrust violation because market shares are unlikely
6 to change?

7 A That's correct.

8 Q So your testimony then is insofar as this criterion is
9 focused upon competitive injury, that is antitrust injury,
10 the answer to the question must be no; isn't that right?

11 A We were looking at the market share issue. From the market
12 share perspective, that's correct.

13 Q All right. Now, that being the case, there is no occasion,
14 is there, to ask whether other benefits in the transaction
15 might compensate for a loss of competition?

16 A If I understand your question correctly, I think you're
17 right.

18 Q So if I'm looking at criteria three and four on the page of
19 the - I think it's on now page 4 of the issues memorandum,
20 Mr. Cantilo, would you agree that those particular criteria,
21 three and four, are inapplicable to our circumstance?

22 A Well, as you probably recall from reading our report,
23 Mr. Mitchell, I think there's some question as to how that
24 statute should be interpreted. But if you interpret it the
25 way you do, I think the answer is right.

1 Q Okay. Now we're up to number five. There is an issue, is
2 there not, Mr. Cantilo, whether this criterion and the
3 remaining criteria set forth in the healthcare service
4 contractor Holding Company Act are a part of the antitrust
5 inquiry or are meant to be stand-alone standards?

6 A Yes, sir.

7 Q Let's put that aside and assume that these criteria do apply
8 independently. And that's what you did; right?

9 A We did.

10 Q So in the context of our case, question number five here is
11 whether the financial condition of New Premera might
12 jeopardize Premera's financial stability or prejudice the
13 interests of its subscribers; correct?

14 A Yes.

15 Q And there's no evidence in this case that it would, is there?

16 A Well, as you know, we're not the accounting consultants, but
17 I'm not aware of any.

18 Q Indeed, isn't the principal driver behind this proposal to
19 strengthen Premera's capital position?

20 A I understand that that's one goal of the transaction.

21 Q Okay. So I think we can write no in the margin there as
22 well.

23 A Was that a question?

24 Q I'm just prompting myself to do so. So we're up to number
25 six. And the sixth item is a bit of a mouthful. Would you

1 agree with me, Mr. Cantilo that this criterion should be
2 translated for our case as follows: Is Premera's conversion
3 proposal unfair and unreasonable to its subscribers and not
4 in the public interest?

5 A Would you repeat your formulation?

6 Q Sure. Is Premera's conversion proposal unfair and
7 unreasonable to subscribers and not in the public interest?

8 A Yeah. I think that's probably a good summary.

9 Q Now, I understand that you believe the last 5 words of this
10 standard may be isolated from the rest of it and applied to
11 various aspects of the proposal, that is a sort of a
12 free-floating public interest test. I want you to assume for
13 purposes of my next question, Mr. Cantilo, that the word
14 "and" in this particular statutory framework means that
15 Premera's subscribers are the principal focus of the standard
16 or at least that their interest and welfare is an
17 indispensable part of the test. Would you assume that for
18 me, please?

19 A I will assume that hypothetically.

20 Q With that assumption in mind, Mr. Cantilo, would you agree
21 that the only part of the OIC Staff's consultant reports that
22 suggests anything that is, quote, "unfair and unreasonable to
23 subscribers" is the model in the PwC economic impact report?

24 A No, not necessarily.

25 Q You heard Dr. Leffler's testimony, did you not, that

1 Premera's practice of pricing its individual and small group
2 products on a statewide basis coupled with the OIC's
3 regulatory requirements means that Premera's premiums are
4 constrained by effective competition?

5 A I did hear him say that.

6 Q And that's true today and it will be equally true after
7 conversion, is it not?

8 A Well, I think you'd have to ask Dr. Leffler whether that's
9 what he intended.

10 Q Did you understand him to be saying that that is a
11 circumstance that will not be altered by the conversion?

12 A I think that's what he meant, yes.

13 Q And you also heard Ms. Hunt acknowledge and I think perhaps
14 Dr. Gold as well, that the PwC model assumes a particular
15 outcome, namely margin improvement in Premera's small group
16 and individual product lines. And it cannot, does not,
17 predict any particular outcome. Do you recall that
18 testimony?

19 A Yes. I think that's its intent.

20 Q In any case, the economic assurances that are included in
21 Exhibit E-8 to the Amended Form A are designed to eliminate
22 the possibility identified in the PwC economic impact report
23 for two years following conversion. Is that not true?

24 A I think that's what they're intended to do, yes.

25 Q So I'm going to write in the margin here, "Premera says no;

1 Staff says potential issue two years down the road." Would
2 you agree with that?

3 A Does it matter?

4 MS. HAMBURGER: Do we get to be in the column,
5 too?

6 Q (BY MR. MITCHELL) Let's go on to the next criterion, if we
7 might, Mr. Cantilo. The next criterion asks whether the
8 competence, experience and integrity of the persons who will
9 control New Premera are such that it would be not in the
10 interest of subscribers and of the public to permit the
11 conversion; is that right?

12 A Yes, sir.

13 Q And you would agree, would you not, that there is no evidence
14 suggesting any problem with the competence, experience and
15 integrity of Premera's board?

16 A We are not aware of any such evidence.

17 Q And the same thing is true, is it not, with respect to
18 Premera's management?

19 A That's correct.

20 Q Indeed, I believe you have personally no question about their
21 integrity; is that right?

22 A That's correct.

23 Q So insofar as this criterion might be sought to be applied
24 here, you would agree that there's no evidence to suggest
25 that there's a problem; correct?

1 A None of which I'm aware.

2 Q One would hope that after two years, if there were any
3 evidence, you would be aware of it.

4 So we come to the last of the criteria in the Holding
5 Company Act, number eight on the OIC Staff's list. It asks
6 whether the conversion is likely to be hazardous or
7 prejudicial to the insurance-buying public; correct?

8 A Yeah. Yes.

9 Q Would you agree with me, Mr. Cantilo, that the evidence here
10 does not establish that the conversion is likely to be
11 hazardous or prejudicial to the insurance-buying public?

12 A No.

13 Q Is this an issue that is different from the criterion that
14 looks at whether there is likely to be harm to subscribers,
15 in the public interest, or different in your view?

16 A I think this is a more focused criteria, criterion.

17 Q If Premera, through the conversion, receives capital that
18 enables it to grow, to offer innovative products and services
19 to more customers, would you not agree with me, Mr. Cantilo,
20 that those would be benefits to the insurance-buying public?

21 A Mr. Mitchell, are you asking me if the company's able to do
22 that; whether it does that or not, is that a benefit?

23 Q Why don't you assume for purposes of my question that it not
24 only is able to do so but actually does so?

25 A I think if the company does all those things, that is good

1 for the public.

2 Q Now, you answered my question no. So what substantial
3 evidence are you aware of, Mr. Cantilo, that suggests that
4 conversion is likely to be hazardous or prejudicial to the
5 insurance-buying public?

6 A The concerns about the potential impact on the Eastern
7 Washington small group and individual markets.

8 Q So that's the PwC economic model issue, is it not?

9 A It's what I just said it is.

10 Q Yeah. As always happens, when I go to different places, I
11 leave my pens. So we're at the end of the list of criteria
12 under the Holding Company Act for evaluating the Form A
13 proposal, are we not?

14 A Yes.

15 Q Let's flip back to the Form D criteria for a moment. This is
16 in the paragraph that precedes the list of criteria that we
17 just discussed. And it relates to intra-Holding Company Act
18 transactions; right?

19 A Correct.

20 Q And we understand each other that those are Form D
21 transactions in the lingo of the Holding Company Act; right?

22 A Yes, sir.

23 Q Those criteria apply to some of the transactions that are
24 subsumed within Premera's application such as the tax sharing
25 agreement and the guarantee agreement; right?

1 A Yes.

2 Q Now, you heard Mr. Tillett testify yesterday, perhaps it was
3 day before yesterday, that the intercompany agreements
4 examined by PwC were fair and reasonable, did you not?

5 A Yes.

6 Q And as I understand your testimony, you would have only one
7 concern relating to the Form D transactions, namely that
8 raised by the guarantee agreement with the State of Alaska's
9 - I'm sorry - the new Alaska subsidiary of Premera; correct?

10 A I think that's all that's left. I think there were other
11 issues, but they've been resolved.

12 Q And you said, I believe, in response to counsel's questions
13 that you had heard Mr. Marquardt's testimony. And while you
14 were comforted by it, you would like to see some change in
15 the language; is that right?

16 A Well, I was not as articulate as you just were, but I think
17 the sentiment is correct.

18 Q So do I understand your testimony to be, Mr. Cantilo, that an
19 appropriate condition to attach to the approval of this
20 transaction should the Commissioner decide to grant it would
21 be to require that the language in the guarantee agreement
22 for New Premera Blue Cross be identical to the language in
23 the guarantee agreement for New Premera Blue Cross of Alaska?

24 A Well, I don't have the language in mind. But to cut to the
25 chase, I think an appropriate condition would require

1 guarantee of replacement of coverage as well as claims
2 guarantee for both states.

3 Q So if that's what the Alaska guarantee now provides, you
4 could apply the same language to Washington and you would be
5 satisfied, would you not?

6 A As to that point.

7 Q And as to that point, I think then you would be satisfied as
8 to all of the Form D transactions, would you not?

9 A Yes, I would.

10 Q So the bottom line, Mr. Cantilo, appears to be this: And I
11 would ask you whether you agree or not with this proposition.
12 If the Holding Company Acts are applied in accordance with
13 their terms, there is no basis on this record to disapprove
14 Premera's proposed conversion, is there?

15 MS. deLEON: Objection. Vague regarding terms.
16 Are we just talking about the terms that we just went through
17 in Mr. Mitchell's definition of the terms?

18 JUDGE FINKLE: Sustained. Please rephrase.

19 MR. MITCHELL: Sure.

20 Q (BY MR. MITCHELL) Would you agree with me, Mr. Cantilo, that
21 if there is a strict interpretation of the Holding Company
22 Acts in this case, the conclusion must be that they would not
23 prohibit transactions?

24 A Are you putting aside the transfer for market value issue?

25 Q I am. Because that's not a Holding Company Act issue, is it?

1 A Maybe my clarification was not sufficient. Putting aside
2 whether there's compliance with the Nonprofit Act?

3 Q Yes.

4 A Yeah. Insofar as the Holding Company Act is concerned, if I
5 understood your question - we have disagreement on how you
6 answered your questions - but if your answers on that piece
7 of paper are right, you might be right.

8 Q Well, I want you to ignore for a moment my handscratching on
9 the document, Mr. Cantilo, and simply answer this question:
10 Is it the case that a strict interpretation of the Holding
11 Company Act would not prohibit this transaction?

12 A No.

13 Q That is not correct is your view; is that right?

14 A My view is that a strict interpretation of the Holding
15 Companies Act does not bar disapproval of this transaction.
16 Is that your question?

17 Q I think it was so . . . Mr. Cantilo, I've put up on the
18 board page 350 from your 2004 deposition. You may recall
19 that there was an e-mail you received from your associate
20 Mr. Taktajian, in which he observed that, quote, "A strict
21 interpretation of the Holding Company Acts would not prohibit
22 the transaction."

23 And I asked you to explain that, did I not? And you
24 said, "I'm not sure what explanation you need. I think
25 that's probably a correct statement."

1 That was your testimony, was it not?

2 A Yes. I think that was focused on a narrow point though.

3 Q Would you agree with me, Mr. Cantilo, that if the proposed
4 conversion is not likely to harm Premera's subscribers or the
5 insurance-buying public, then the foundations that are
6 proposed to be established via this transaction are a bonus
7 to the public of this state and the State of Alaska?

8 A No.

9 Q You do not agree that the proposed foundations will be found
10 to the benefit of Washington and Alaska citizens?

11 A No. I agree with that statement.

12 Q And do you have a reason for suggesting that if there is not
13 a violation of the Holding Company Act, that there is
14 nevertheless a reason to reject the foundations?

15 A It's not a question of rejecting the foundations,
16 Mr. Mitchell.

17 Q You agree with me, do you not, Mr. Cantilo, that the
18 Commissioner should consider the positive effect of the
19 Washington foundation in particular in addressing unmet
20 health needs of Washington residents?

21 A I think the Commissioner has authority to do that.

22 Q Well, beyond that, Mr. Cantilo, you believe that he should
23 consider it, do you not?

24 A I will not presume to tell the Commissioner what he should
25 do.

1 Q Well, perhaps you would not to his face. But you were not
2 hesitant to do so when we were talking in deposition, were
3 you?

4 A Slap me around.

5 Q So if you were to put aside for a moment your desire not to
6 be presumptuous, Mr. Cantilo, would you agree that the
7 Commissioner should consider the positive effects of the
8 foundation in addressing unmet health needs as to the kinds
9 of programs that were described by Mr. Reid in his
10 testimony?

11 A Well, as I said, I think he has authority to do that. I
12 think you can fashion the argument that if there's a
13 disadvantage perceived in the transaction, you should balance
14 it against the advantages resulting to the foundations. Is
15 that what you're referring to?

16 Q Well, it's actually the flip side of my earlier question,
17 Mr. Cantilo, in which I asked you this question: If the
18 proposed conversion is not likely to harm Premera's
19 subscribers or the insurance-buying public, would you not
20 agree that the foundations' benefits are an added bonus of
21 this proposal?

22 A I understood your question the first time. I still do not
23 agree with that proposition.

24 Q You are suggesting then that the - perhaps the advantages of
25 the foundations - the benefits of the foundations should be

1 foregone because you don't like the terms under which those
2 advantages would be realized; is that right?

3 A No. What I'm suggesting is that the public has a legal right
4 to the fair market value of a company. And to characterize
5 less than the fair market value of a company as a bonus is
6 inappropriate.

7 Q Well, let's ask - let me ask a few questions about that
8 point, if I might, Mr. Cantilo. Would you confirm for me
9 that there is nothing in the - either the Holding Company Act
10 or the Washington Nonprofit Corporation Act or the Washington
11 Miscellaneous Corporation Act that requires the transfer of
12 fair market value?

13 A No, I don't agree with that. I agree with you term that the
14 term fair market value is not used.

15 Q Would you confirm for me, Mr. Cantilo, that your analysis of
16 many of the issues in this case is predicated upon the
17 assumption that Premera is a charity legally obligated to
18 transfer 100 percent of its assets to the public?

19 A Well, the precise assumption was there was agreement that
20 Premera would and had agreed to transfer a hundred percent of
21 its market value. We may have made the assumption, which is
22 irrelevant to our conclusions, that the basis of that
23 agreement was I believed that it had a charitable obligation.

24 Q Well actually I think you were a little bit more specific
25 than that, were you not? Did you not assume both that

1 Premera was legally obligated to transfer all of its assets
2 through their conversion and that Premera was a charity,
3 100 percent of the assets of which were subject to charitable
4 trust restrictions.

5 A No. I think I was clear, Mr. Mitchell, during our
6 deposition. We actually didn't analyze that question.

7 Q Indeed, that was going to be my follow-up. Did you not
8 assume that without analysis?

9 A Well, I'm not sure how you mean assume. As I said, that
10 would not have been a necessary assumption for our analysis
11 because the basic assumption was that there was agreement
12 that Premera would transfer a hundred percent of its market
13 value. So it wasn't necessary that we make a further
14 assumption. We may have made that observation in passing.
15 But I don't know that I would use that as an assumption in
16 the way in which I use that term.

17 Q Let's be straight about this, Mr. Cantilo. You were
18 instructed to make that assumption before December of 2002,
19 were you not?

20 A We were instructed to assume that it was unnecessary to
21 analyze whether the obligation existed because there was
22 agreement on that point.

23 Q We will get exactly to what you were instructed to assume in
24 a moment. I want to ask you a couple of questions about the
25 allocation analysis, Mr. Cantilo. Is it not the case that

1 the assumption underlying your legal opinion regarding
2 allocation between Washington and Alaska, which is
3 Exhibit S-34, was that Premera is a charity legally obligated
4 to transfer a hundred percent of its assets to the public of
5 Alaska and Washington?

6 A I think we may have made that assumption for purposes of that
7 analysis, yes.

8 Q And the very same assumption underlies your legal opinion
9 written in response to an inquiry from the Oregon Attorney
10 General, doesn't it?

11 A No. I don't think that assumption was necessary for the
12 Oregon opinion.

13 Q Well, let's put that aside because that really didn't go very
14 far, did it, Mr. Cantilo?

15 A I don't understand what you mean by that.

16 Q The Oregon inquiry. You never undertook to establish the
17 validity of your assumption about Premera's assets being
18 encumbered by charitable trust obligations, did you?

19 A That's correct.

20 Q And you would agree, would you not, Mr. Cantilo, that if
21 Premera is not subject to a charitable trust obligation to
22 the State of Alaska or in the State of Alaska, that Premera
23 could limit the scope of its foundation activities to
24 Washington?

25 A I . . . That's not enough information to answer that

1 question, Mr. Mitchell. If you assume further, as I think I
2 told you the last time you asked me this question, that the
3 company has no other obligation in Alaska, then the answer
4 might be yes.

5 Q Is it not the case, Mr. Cantilo, that it is based upon the
6 assumption that they are both entitled to claim a share of
7 the proceeds of conversion, that the states, and more
8 particularly the states' consultants, have been haggling over
9 the allocation issue for many months?

10 A No. Well, I shouldn't say that. I don't know how you define
11 many months. The discussion of allocation is pretty recent
12 among the two states. It does probably exceed two months, so
13 you might characterize it as many months.

14 Q My basic question is: Is it not the case that the
15 disagreement, the argument, the discussion on this subject is
16 predicated upon the assumption that both states are entitled
17 to a share of the proceeds?

18 A Yes.

19 Q Now, we witnessed a part of this dispute yesterday when
20 Mr. Staehlin sought to defend himself against claims of
21 improper adjustments and actuarial adjustments lodged by the
22 consultants to the Alaska Division for Insurance. Were you
23 here for that testimony?

24 A Yes, I was.

25 Q Do you mean how many dollars of consultant fees can be traced

1 to this dispute over allocation, Mr. Cantilo?

2 MS. deLEON: Objection. Speculative.

3 JUDGE FINKLE: Overruled. If you know, go ahead
4 and answer.

5 A I can tell you on our part. I could not begin to fathom a
6 guess on the other consultants. In the case of the work that
7 we have done, not one penny.

8 Q (BY MR. MITCHELL) With respect to the work that has been
9 done by the actuarial and the investment banking consultants
10 who have been been carrying on the bulk of this discussion,
11 you don't know, do you?

12 A I do not know.

13 Q You do know though, don't you, that all of those fees have
14 been charged to Premera?

15 A I'm sorry, Mr. Mitchell. I want to help you. But since I
16 don't know whether there are any, and if there are any, I
17 don't know how much, I don't know whether they've been
18 charged to Premera. I can assure you that the arrangement we
19 had was such that Premera did not pay us one more penny on
20 account of the allocation issue than it would have without
21 it.

22 Q Well, that's comforting, Mr. Cantilo. Let me ask you this:
23 Would you agree with me that if Premera is not a charity,
24 that it would have been more appropriate and certainly far
25 cheaper to accept - have accepted Premera's proposal for a

1 90/10 split between the states?

2 A Are you asking me what Alaska would have done?

3 Q Well, I want to put aside for a moment what Alaska would have
4 done and ask you from the standpoint of a consultant to the
5 Washington Insurance Commissioner.

6 A So the premise is that there's no obligation on the part of
7 Premera?

8 Q Yeah.

9 A If the company had had no obligation, then accepting a
10 90 percent gift would have been easier, yes.

11 Q Let's assume for a moment, if we might, Mr. Cantilo, that the
12 actuarial and the investment banking consultants to the OIC
13 and to the ADI could be persuaded or perhaps were instructed
14 to put down their weapons in this war of --

15 MS. HAMBURGER: Objection. It's argumentative.

16 JUDGE FINKLE: Sustained.

17 Q (BY MR. MITCHELL) Let's assume for a moment, Mr. Cantilo,
18 that the investment banking and the actuarial consultants in
19 the two states were instructed to cease their dispute and
20 that the difference between them was split. Let's assume
21 that's an 80/20 split. Would you do that for me, please?

22 A I will make the hypothetical assumption.

23 Q And as compared with Premera's initial proposal, would you
24 not agree with me that that would represent a swing of
25 perhaps 60 to 70 million dollars more to Alaska and less to

1 Washington than Premera's initial proposal?

2 A I haven't done the math. I understood the original proposal
3 by Premera to be 88/12. So I suppose you're talking about an
4 eight percent swing of the consideration.

5 Q And if the Alaska consultants' figures were accepted, the
6 result would be somewhere more like 20 percent of the whole
7 going to Alaska over Premera's initial proposal; right?

8 A You may be right. There have been a lot of ranges proposed
9 by Alaska. I think one had Alaska receiving more than
10 40 percent so . . .

11 Q I'm just assuming 32 for the purposes of my question.

12 A Okay. Then you're right.

13 Q And if that were the outcome, the result would be a
14 difference of \$120 million roughly speaking going to Alaska
15 instead of to Washington; right?

16 A Mr. Mitchell, you're making an assumption about gross
17 proceeds of which I'm not aware so . . .

18 Q I grant you that I'm using the illustrative example from the
19 Blackstone report. But if you take that as an appropriate
20 range - it's the best one we have - would you grant my
21 arithmetic?

22 A Yes.

23 Q So for the residents of Washington as well as for Premera,
24 would you not agree with me that the dispute over entitlement
25 to these proceeds has resulted in people being significantly

1 worse off by dint of the long and so far fruitless --

2 MS. HAMBURGER: Objection. It's argumentative.

3 JUDGE FINKLE: Overruled.

4 Q (BY MR. MITCHELL) -- long and so far fruitless dispute
5 between the states over allocation?

6 A I think it's unfortunate that the agreement has not been
7 reached yet. But given that the transaction has not closed,
8 I don't see any harm having flown so far - flowed rather,
9 from the lack of agreement.

10 Q Well, one potential source of harm I guess, from our
11 perspective, is that we have to deal with the unallocated
12 shares escrow agreement, do we not?

13 A I would answer it the same way. I continue to harbor hope
14 that the issue will be resolved before the transaction
15 closes, in which event I guess the harm is that someone had
16 to draft the unallocated shares escrow agreement. But in the
17 context of the tall mountain of documents that have been
18 drafted, unfortunate as it may be, it may not be an
19 unacceptable price.

20 Q Now, in addition to the allocation opinion that you - your
21 office prepared, Mr. Cantilo, is it not the case that
22 substantial portions of both your original report and your
23 supplemental report are based upon the assumption that
24 Premera is a charity?

25 A I think we may have mentioned that assumption. But as I've

1 said earlier, it's not necessary to the conclusions for the
2 reason I've explained, which is the core assumption was that
3 there was agreement on the obligation to transfer fair market
4 value.

5 Q Mr. Cantilo, do you recall testifying on March 22nd of this
6 year in your deposition, page 281, in response to my
7 question, "That assumption, same assumption, underlies the
8 analysis of both your original report and your supplemental
9 report in this case, does it not?" You said, "I believe
10 that's true."

11 A I don't have my deposition in front of me. But I believe
12 you. That sounds like something I would have said. If you
13 can tell me what exhibit number it is and if it's in the book
14 of exhibits, I'm happy to find it.

15 Q I think it's on the floor before you.

16 A What's the exhibit number?

17 Q It is the deposition dated - I'm not sure what you have
18 before you. Do you have the exhibits?

19 A I have the book of Premera's exhibits.

20 Q Let's move on in the interests of time, and I will hand you a
21 copy of your deposition if you'd like it.

22 MR. HAMJE: If I may approach the witness.

23 JUDGE FINKLE: Yes.

24 MR. HAMJE: (Handing to witness.) Thank you.

25 Q (BY MR. MITCHELL) Mr. Cantilo, is it not the case that

1 assertions in your reports that Premera's proposal does not
2 deliver, quote, "the requisite value," closed quote, to the
3 foundations because of restrictions placed upon the
4 foundations in voting and disposing of that stock rest
5 entirely upon the assumption that Premera is currently owned
6 by the public?

7 A Well, if I said that, that may have been overgeneralizing it.
8 I think the better statement is rest entirely upon the
9 assumption that Premera is obligated to transfer its fair
10 market value.

11 Q Well, that assumption is based upon the underlying assumption
12 that Premera is currently owned by the public, is it not?

13 A No. As I've said earlier, we actually didn't analyze that
14 issue.

15 Q Is it not the case, Mr. Cantilo, that statements in your
16 reports about the applicable legal requirement, when used in
17 the context of the transfer of the shares to the Washington
18 and Alaska foundations, is equivalent to your assumption that
19 the public owns Premera and, therefore, Premera is obligated
20 to transfer 100 percent of its value to the states?

21 A Yeah. I think those are functional equivalents.

22 Q Now, among the - the issues that hinge upon that assumption
23 is the question you raise in your report and in your
24 testimony here that the voting trust agreement will survive
25 the loss of the Blue marks, is it not?

1 A I'm sorry, Mr. Mitchell. Could you repeat your question.

2 Q Let me try a different question, if I might, Mr. Cantilo. Is
3 it not the case that the assumption that we just discussed is
4 the sole base - basis for your conclusion that Premera is
5 legally obligated to transfer the fair market value of its
6 assets to the foundations?

7 A I don't want to continue quarreling with you on this one.
8 Let me just make sure that when you ask me about the
9 assumption, we mean the same thing. If you mean my
10 assumption that Premera has the obligation to transfer its
11 fair market value, then the answer is yes. If you mean
12 something more specific than that, as I've said, we have not
13 analyzed the charitable obligation issues. So the answer
14 might be different.

15 Q Your assumption that Premera is legally obligated to transfer
16 the fair market value is predicated upon the assumption that
17 Premera is currently owned by the public, is it not?

18 A No. That assumption is premised presently on the fact that
19 Premera has filed the application based on that undertaking.

20 Q Are you going back now to the Form A language that you
21 latched up on the screen for us this morning, Mr. Cantilo?

22 A Well, those were illustrations. But I think from the very
23 beginning, that has been the premise of the application.

24 Q Actually the premise of the application, is it not, is that
25 the Premera will transfer a hundred percent of the initial

1 stock of New Premera to the foundation, and of course, that
2 stock comes from any restrictions that are associated with
3 the documents in which that commitment is made?

4 MS. HAMBURGER: Objection. Counsel is
5 testifying.

6 JUDGE FINKLE: Overruled.

7 A No.

8 Q (BY MR. MITCHELL) No?

9 A No. Did say 100 percent of the stock in some places, but it
10 also says all of the assets in other places. It says all of
11 the company in other places. And of course, the articles say
12 all of the assets. So it's not simply 100 percent of the
13 stock subject to restrictions. Indeed, for the most part,
14 wherever your application says transfer 100 percent of the
15 stock, it does not say subject to restrictions as we may
16 impose.

17 Q That is true. But language appears in the paragraph that
18 talks about the terms under which it's being transferred
19 being those set forth in the Amended Form A; right?

20 A Could you repeat that question.

21 Q Sure. If the language does not say subject to the conditions
22 and restrictions, it does nevertheless appear in the context
23 of language talking about the transfer being part of the
24 transaction documents that are, in fact, the subject of the
25 Amended Form A?

1 A Okay. If I'm tracking with you, you're right, the language
2 appears in documents that refer to the other transaction
3 documents.

4 Q And is it your position, Mr. Cantilo, that this commitment is
5 different from the commitment that we talked about
6 hypothetically involving the house on a lot and an easement
7 and restrictive covenants?

8 A I don't know enough about that hypothetical to know whether
9 it's the same or different.

10 Q Is it your position, Mr. Cantilo, that the foundations could
11 demand delivery of the assets of a corporation which is - has
12 the benefits and burdens associated with the Blue mark - Blue
13 Cross trademark license without any of the restrictions that
14 follow from that license?

15 A Well, as I think I answered your other hypothetical, that
16 depends on the circumstances.

17 Q You have assumed here, have you not, Mr. Cantilo, that,
18 indeed, the foundations can take the benefits without the
19 burdens?

20 A No, Mr. Mitchell. What I assumed is that the burdens sought
21 to be imposed on the foundations are beyond those that are
22 actually required by the licensing agreement and that it is
23 possible to subject the foundations to a lesser set of
24 restrictions or conditions than those that are proposed in
25 the transaction.

1 Q And that's because you think that Mr. Barlow should go back
2 and talk to his friends at the association and negotiate a
3 better deal; is that right?

4 A It's not because of that, although I do think that Mr. Barlow
5 should go back and talk to the other CEO's who run the
6 association. But --

7 Q Mr. Barlow has already done that, hasn't he?

8 A As I said earlier, Premera reported that he made at least one
9 effort this year.

10 Q And are you aware, Mr. Cantilo, that the Blue Cross/Blue
11 Shield Association contains many members whose position it is
12 that there should not be any more conversions of entities
13 and, therefore, that there should be no relaxation of the
14 restrictions in the license?

15 A I don't have personal knowledge of that, no.

16 Q You have no basis to believe, do you, that Mr. Barlow,
17 accompanied by legal counsel, did not make the most vigorous
18 argument that he could to secure, for the benefit of the
19 foundations, two five percent blocks of stock outside of the
20 voting trust?

21 A Mr. Mitchell, I don't have any idea what was said and done in
22 connection with that effort. I don't mean by that to
23 criticize Mr. Barlow in any sense. But I have no clue what
24 effort was made.

25 Q Of course, you would have had such a clue had you availed

1 yourself of the invitation to go along, wouldn't you?

2 A A clue perhaps.

3 Q I would like you to confirm for me, Mr. Cantilo, the
4 following proposition: That you have not undertaken to
5 analyze or to establish the validity of the assumption that
6 underlies much of your analysis, specifically that Premera is
7 either charitable or a public benefit corporation under
8 Washington law.

9 A I agree with you that I have not taken - undertaken to
10 analyze whether Premera is a charitable public benefit
11 corporation. I do not agree with you that that's an
12 assumption underlying much of our analysis.

13 Q Would you agree with me, Mr. Cantilo, that the assumptions
14 you have made and that underly your analysis have no force of
15 law; they are not a legal conclusion but only an assumption?

16 A My assumptions never have the force of law.

17 Q Would you agree with me, Mr. Cantilo, that your reports
18 cannot be viewed as an effective refutation of the analysis
19 done by Mr. Steel regarding the public ownership and
20 charitable trust doctrines?

21 A This will surprise you. No.

22 Q Didn't you tell Mr. Hamje that your reports cannot be viewed
23 as an effective refutation of that analysis?

24 A You're going to have to be more specific, Mr. Mitchell, which
25 analysis of Mr. Steel you're talking about. In fact, I think

1 Mr. Steel and we agree on the principal issue, which is the
2 obligation under the Nonprofit Act.

3 Q You agree with Mr. Steel?

4 A I choose to think he agrees with us since we wrote first
5 but . . .

6 Q Do you recall a somewhat lengthy discussion in your
7 deposition on March 22nd about the instructions you had
8 received from Mr. Hamje about the assumptions you were
9 supposed to make?

10 A I recall our discussions generally, yes.

11 Q And do you recall my asking you about whether you had had any
12 subsequent conversations with Mr. Hamje on the topic of the
13 assumptions that he asked you to make?

14 A I don't recall you asking me that, no.

15 Q If you would look at pages 283 and 284 of your March 22nd
16 deposition, Mr. Cantilo, starting on line 23.

17 A I'm there.

18 Q The question was: "Did you have any subsequent conversations
19 with Mr. Hamje on the topic of this assumption?"

20 Answer, "I think I had one after I saw the reports of
21 Premera's experts following our initial round of reports -
22 rounds of reports rather - or rather our round of initial
23 reports, and I expressed surprise to Mr. Hamje that Premera
24 apparently was now taking the position that this was an
25 uncited issue and I explained to him that our report cannot

1 be viewed as an effective refutation of this new position by
2 Premera because we had not done any of the requisite
3 analysis."

4 Do you see that?

5 A Yes.

6 Q So you were referring there to the reports of Mr. Steel, were
7 you not?

8 A Only Mr. Steel's lengthy discussion of Premera not being a
9 charitable organization, which I think is completely
10 irrelevant to this proceeding.

11 Q Really. Why did you have extended conversations and
12 communications with Mr. Fallis on a subject which you were
13 commenting upon the fact that Premera bears none of the
14 hallmarks of a charity other than its nonprofit corporate
15 status?

16 A We were probably answering Mr. Fallis's questions.

17 Q Would you not agree with me, Mr. Cantilo, that Premera has
18 not registered nor does it operate as a charitable
19 organization?

20 A Yes.

21 Q Would you agree with me as well that nonprofit structure does
22 not mean that a corporation is either charitable nor a public
23 benefit corporation under Washington law?

24 A That's correct.

25 Q Do you recognize, Mr. Cantilo, that if your assumption is

1 mistaken, many of your objections to particular transaction
2 terms have little or no merit?

3 A Which assumption?

4 Q Well, let's look at pages 287 and 288 of that deposition,
5 Mr. Cantilo.

6 A I'd rather you just tell me which assumption.

7 Q Let's look at page 287, line 7, Mr. Cantilo. The question
8 was, "At any point during your work on this project, did you
9 consider the consequences of making a different assumption
10 about the supposed legal obligation on the part of Premera to
11 dedicate 100 percent of its assets to charitable purposes?"

12 And you said, "Yes."

13 And then later on I said, "Can you describe for me what
14 consequences you would consider?"

15 And you said among other things, that you understood
16 and, "expressed the view internally that some concerns
17 articulated in our reports about the proposed structure of
18 the transaction would have a lot less merit or no merit at
19 all if there were not a requirement for the conveyance of a
20 specific consideration or value by Premera to the foundations
21 as part of the conversion."

22 Did you give that testimony?

23 A Yes.

24 Q I want to talk for a moment if I might about another statute
25 that you referred to in your reports, Mr. Cantilo, that being

1 the nonprofit hospital conversion statute. Are you familiar
2 with that?

3 A Yes.

4 Q You agree with me, Mr. Cantilo, that the hospital statute
5 does not apply to Premera's application in this proceeding?

6 A It does not by its terms apply to this transaction. No.

7 Q And is it not the case that Mr. Fallis instructed you or
8 advised you rather, after you inquired, that there was no
9 judicial authority for applying the hospital statute in this
10 proceeding by analogy?

11 A I think that's right. I think he told us that there was no
12 precedent for doing that.

13 Q And Mr. Fallis also urged you not to cite specifically to the
14 hospital statute as there are some potentially unfavorable
15 comparisons to be made, that is to say unfavorable to the
16 regulators. Is that not true?

17 A That sounds familiar, yes.

18 Q Mr. Steel discusses the hospital statute in his pre-filed
19 testimony, does he not?

20 A Yes.

21 Q And as he notes, the Washington Legislature rejected the
22 provision in the model act that had been proposed --

23 MS. HAMBURGER: Objection. Misstates the
24 evidence.

25 JUDGE FINKLE: Go ahead and finish the question.

1 Q (BY MR. MITCHELL) Do you recall from Mr. Steel's pre-filed
2 testimony a discussion of the Washington Legislature's
3 treatment of the model act proposed by the National
4 Association of Attorneys General?

5 A I don't recall the specifics, but I recall he takes up that
6 subject.

7 Q And do you recall as well that the model act that was - came
8 before the Legislature, when it enacted the nonprofit
9 hospital statute, would have applied not just to hospitals,
10 but also to healthcare service contractors?

11 A I think that's right.

12 MS. HAMBURGER: Object. It misstates the
13 evidence. There's no evidence that the model act was before
14 the Washington State Legislature.

15 JUDGE FINKLE: Sustained.

16 MR. MITCHELL: I think the question was about
17 Mr. Steel's analysis.

18 A That's how I interpreted the question. I'm sorry. That's
19 what Mr. Steel says. I agree with Ms. Hamburger. I don't
20 know that that's truly what happened. But that's what
21 Mr. Steel said.

22 JUDGE FINKLE: It'll stand, the testimony.

23 Q (BY MR. MITCHELL) Mr. Steel also observes that the Holding
24 Company Act was passed after the hospital statute and that
25 the Holding Company Acts contain nothing similar to the

1 standards in the hospital statute, does it not?

2 A Would you repeat that again.

3 Q Sure. Is it not the case that Mr. Steel observes that the
4 Holding Company Act - I'm sorry - the Holding Company Act for
5 healthcare service contractors postdates the enactment of the
6 hospital statute and that the Holding Company Act contains
7 nothing similar to the standards in the hospital statute?

8 A I don't recall if those were his words. I think he does make
9 the first observation, that Holding Company Act postdates the
10 conversion statute. I don't recall what comparison he draws
11 between them.

12 Q You have not sought to refute Mr. Steel's analysis or his
13 conclusions regarding the hospital statute, have you?

14 A 70.45?

15 Q Yes.

16 A No.

17 Q Mr. Cantilo, you made some observations in your direct
18 testimony about concerns over management entrenchment. Do
19 you remember that testimony?

20 A Yes, sir.

21 Q Is a somewhat less pejorative term for management
22 entrenchment continuity of management?

23 A The way I used the words entrenchment and continuity mean
24 different things. So I do not believe that they're
25 functional - they're each other's functional equivalent in

1 this context.

2 Q Would you not agree with me, Mr. Cantilo, that the only
3 requirement of continuity or, as you use the term,
4 entrenchment in the Blue Cross/Blue Shield Association rules
5 is for the board of directors?

6 A That is correct, as far as I know.

7 Q And that does not encompass management, does it?

8 A Well, my understanding of the way most corporations,
9 including Premera work, the board hires management. Assuming
10 as I do in some cases that there is a good relationship
11 between management and the board, retaining the board
12 provides a high level of confidence that management will stay
13 in place. Conversely, a wholesale change in the board, in my
14 experience, typically results in material changes in
15 management.

16 Q Would you not agree with me, Mr. Cantilo, that it would be
17 advantageous to the subscribers of a health insurance company
18 if the board, following a transaction, were knowledgeable
19 about the business?

20 A All other things being equal, I think that's a desirable
21 characteristic.

22 Q And I assume that you would also find it desirable that the
23 board members be competent in running an insurance company
24 and understanding the markets in which that insurance company
25 offers products, indeed, to their being known to the

1 regulators of that insurance company.

2 A I'm sorry. What was the last part? Their being known to the
3 regulators?

4 Q Correct. As opposed to strangers.

5 A Well, by itself, whether or not the board is known to
6 regulators can be a plus or a minus. I know many boards that
7 I wish I hadn't known. On the other hand, I think that it's
8 true that it's desirable for management and the board to have
9 experience in the markets and in the business of the company,
10 again all other things being equal.

11 Q And in this case, I take it you're not suggesting that you
12 would wish not to have known the board or management of
13 Premera, do you - are you?

14 A I have not met most of the board of Premera. The gentlemen
15 and ladies I've met of the management team, all of them have
16 been very professional and seem to be competent - very
17 competent.

18 Q Now, with respect to the question of two five percent blocks
19 of shares outside of the voting trust, Mr. Cantilo, that was
20 one of the issues that Mr. Barlow and his team went back to
21 the Blue Cross/Blue Shield Association on behalf of the
22 position advanced by the state's consultants, was it not?

23 A That's what we were told.

24 Q And you are aware from the written communication that
25 Mr. Barlow received that the Blue Cross/Blue Shield

1 Association was not willing to accede to that request; is
2 that right?

3 A So far.

4 Q And the default provision in the Washington Form A, and,
5 indeed, in the Alaska Form A, is for the single block of
6 shares to be divided between Washington and Alaska as they
7 might agree, or failing agreement, that it all go to the
8 Washington foundation, is it not?

9 A That's correct.

10 Q So insofar as you are expressing a concern here about one
11 versus two blocks of shares, are you not representing the
12 interests of Alaska more than the interests of Washington?

13 A I think the State of Washington has an interest in preserving
14 a harmonious relationship with its sister state in Alaska.
15 And that provision unnecessarily creates disharmony or
16 tension between the two states.

17 Q Only if they can't agree; isn't that right, Mr. Cantilo?

18 A I suppose you can make that assumption.

19 Q Now, on the --

20 A Although . . . Actually not.

21 Q Let me --

22 A Well, I'm changing my answer. That's not true.

23 Q You earlier testified, I believe, that there's nothing in the
24 Holding Company Act that speaks to the issue of fair market
25 value; is that right?

1 A That's correct.

2 Q And what do you mean by --

3 A I'm sorry. I don't remember everything in the Holding
4 Company Act. There's nothing in the act with respect to this
5 transaction that imposes a fair market value requirement.

6 Q What do you understand the term fair market value to mean in
7 this context, Mr. Cantilo?

8 A As a general proposition, what a willing buyer not under
9 duress is willing to pay a willing seller also not under
10 duress when both have adequate information.

11 Q In this case, the fair market value of the stock to be
12 received by the Washington foundation would be known only
13 upon the point at which the stock is transferred from a
14 willing seller, that being the foundations, to a willing
15 buyer, that being a nonrelated investor, in the public
16 markets following the conversion and IPO; isn't that right?

17 A No. I'm not sure that's right. If the foundations were to
18 hold 100 percent unrestricted stock on the day of the
19 offering, I think you could determine the fair market value
20 of the stock on the day of the offering, even though the
21 foundation may not sell it for quite some time after that.

22 Q Well, in this transaction, given that all of the stock is not
23 going to be sold immediately and there are restrictions
24 associated with it, the fair market value will be determined
25 over time, will it not?

1 A The fair market value of the restricted stock will be
2 determined over time. That's correct.

3 Q And there is no reason to believe that a buyer is going to be
4 willing to pay less for the stock because of the restrictions
5 because the restrictions have no application to the buyer;
6 isn't that right?

7 A That's correct.

8 Q Now, insofar as the fair market value standard has been
9 embraced by you in this proceeding, would you agree with me
10 that the questions that are encompassed by that standard are
11 unrelated to the interests of Premera's subscribers?

12 A In their capacity solely as subscribers, I think that's true.

13 Q I want to talk to you briefly about the joint divestiture
14 schedule, Mr. Cantilo. You raised a concern about the
15 application of that schedule because of the potential for a
16 problem in the performance by one party being visited upon
17 the other party. I think that's called the cross-default
18 position, is it not?

19 A I mentioned the cross-default provision. I don't recall - I
20 didn't recall the name at the time so I probably didn't call
21 it that. But I did mention that effect.

22 Q And would it not be an appropriate solution to this issue, at
23 least to avoid such an issue, to provide for a proportional
24 divestiture schedule with no cross-default provision? If
25 Alaska say failed to satisfy its obligations under the

1 divestiture schedule, the shares that it failed to divest
2 would go into the excess share allocation agreement; is that
3 right? I'm sorry. Excess share agreement?

4 A I agree with you that a proportional schedule would resolve
5 that one issue.

6 Q And indeed, there are indications in that letter from the
7 BCBSA that the BCBSA would find that an acceptable solution,
8 are there not?

9 A I don't recall that, but I take your word for that.

10 Q Do I understand your testimony here today, Mr. Cantilo, to be
11 that you could recommend this transaction only if Premera
12 were willing to fight the Blue Cross/Blue Shield Association
13 on the premises that the Blue Cross/Blue Shield Association
14 has asserted in let's say the WellChoice transaction?

15 A I'm sorry. Would you say the last part again. On the
16 premises that what, sir?

17 Q The premises that it had previously expressed unwillingness
18 to go beyond, for example, in the WellChoice transaction?

19 A No. I mean I don't think . . . I think there are aspects of
20 WellChoice that are applicable to this transaction but there
21 were aspects of WellChoice that are not. So it's not our -
22 it's not my position that Premera ought to fight the
23 association to apply the same conditions here as WellChoice,
24 if that's your question.

25 Q I think I may have misled you by throwing WellChoice into the

1 equation. Let me ask the question more directly. Is it your
2 position that you could not recommend this transaction to the
3 Commissioner without additions that would require Premera to
4 renegotiate with the Blue Cross/Blue Shield Association the
5 terms that the Blue Cross/Blue Shield Association has already
6 said it will not accept?

7 A I don't know that. I don't know what the association has
8 said. I do think that . . . My position is that the
9 Commissioner should not approve the transaction as currently
10 constituted, and a part of that is conditions imposed upon
11 the stock which Premera attributes to the association.

12 Q Don't you think you could have saved Premera \$31 million by
13 advising them at the outset that you couldn't recommend the
14 transaction unless it required Premera to renegotiate such
15 terms with the BCBSA?

16 A We did advise Premera of many of these issues in late 2002 or
17 early 2003. I don't know how much could have been saved, and
18 I don't know what Premera was or was not willing to do. I
19 think it's notable that the efforts were made in 2004.

20 Q Why is it, Mr. Cantilo, that you believe the terms of the
21 Amended Form A do not transfer fair market value to the
22 Washington foundation?

23 A Well, I think the reasons are in our report and I testified
24 about them on direct. But as one illustration, they may have
25 the effect of requiring the foundations to hold stock or to

1 sell stock at a time when either of those decisions would
2 result in the foundations being able - though willing, being
3 unable to realize the maximum value of that stock.

4 Q So it's the divestiture schedule that's basic to your
5 analysis; is that right?

6 A Well, as I said, that's one illustration. There are others.
7 We can go back through it if you want, Mr. Mitchell. I think
8 I'm using the Court's time and your own by doing that. I
9 should have said Commissioner. I'm sorry.

10 Q Mr. Cantilo, is it still within the realm of possibility for
11 you to put up the slide that you had earlier that was
12 captioned Form A?

13 A Yes. I don't think I control the projector but I . . . Tell
14 me which one because I had several. This one?

15 Q I believe that was it.

16 A I had one more, Mr. Mitchell. Did you want to see the next
17 page?

18 Q It's the next one, I believe, Mr. Cantilo.

19 A This one where it says a hundred percent of its assets? It
20 doesn't say stock.

21 Q That's the one, Mr. Cantilo. 100 percent of its assets
22 consisting of all of the stock of New Premera. Correct?

23 A Right. I'm not seeing the words subject to restrictions or
24 conditions in there.

25 Q Could you read the following two sentences.

1 A "The form of the Premera plan of reorganization is attached
2 hereto as Exhibit G-18. The form of the Premera plan of
3 distribution is attached hereto as Exhibit G-19.

4 Q Is it not the case, Mr. Cantilo that the plan of
5 reorganization and the plan of distribution referenced in
6 this language contain the very restrictions that you are now
7 objecting to?

8 A Well, there have been some restrictions in the earlier
9 versions. There are restrictions in the new versions. But
10 there are restrictions in those two documents, definitely.

11 Q There is nothing in the Form A, is there, that says that
12 Premera is committing to transfer 100 percent of the fair
13 market value or anything like it?

14 A I do not recall anything in the Form A that says it's
15 transferring 100 percent of its fair market value.

16 Q And you - I think you testified you assumed that Premera
17 agreed to this proposition that it was obligated to make such
18 a transfer; is that correct?

19 A Yes. I was relying in part on this confirmation that came
20 from a letter you wrote actually.

21 Q The unreliable source from November - November 15th - I'm
22 sorry - October 15th, 2003. This was after your report was
23 done; is that right?

24 A Yes. It was in response to this precise point in my report.

25 Q And in fact, the bullet above the one that this is a part

1 of . . . I'm sorry. I don't think you put the bullets from
2 the Exhibit 7 up, Mr. Cantilo. And maybe you can shut this
3 off.

4 A Mr. Mitchell, I think that's the bullet you're talking about.
5 See how helpful I am?

6 Q You are very helpful. Did you ever ask Premera to - whether
7 it had agreed that it was a charity or thought it was legally
8 obligated to transfer a hundred percent of its value to
9 anyone?

10 A That was, I think, the first of the issues that were on the
11 structural issues list communicated to Premera in
12 February 2003.

13 Q And I believe your testimony is that Mr. Domeika refused to
14 tell you that, did you not?

15 A I don't think I said refused. I think the explanation I got
16 from Mr. Domeika was that the company's decision had been to
17 postpone response to our requests and observations until the
18 final reports were made in February - I'm sorry - in October.

19 Q And so you went forward, based upon this assumption, without
20 any commitment by the company to accept the premise upon
21 which you were operating; is that right?

22 A We received no such commitment.

23 Q And you had in your possession, did you not, communications
24 from Premera to the Commissioner and to the Attorney General
25 from May of 2002 in which it specifically disavowed any

1 suggestion that it was a charity?

2 A That's correct, yes.

3 Q And you had in your possession a memo from your colleague,
4 Mr. View (phonetic), advising you that Premera was not a
5 charity and was taking the position that it was not a charity
6 in December of 2002, did you not?

7 A That's all correct, yes.

8 Q And the instructions that you received from Mr. Hamje to make
9 certain assumptions in this case predate by at least
10 11 months the document which is up on the screen. Is that
11 not true?

12 A Yes. I think that's right.

13 Q Last question, Mr. Cantilo. Does not the Form A document
14 itself state that Premera is not a charity?

15 A I don't recall, Mr. Mitchell. But I - it probably does. It
16 would not surprise me.

17 MR. MITCHELL: Thank you. Nothing further.

18 MS. deLEON: Your Honor, we have --

19 JUDGE FINKLE: I'm sorry. Kind of jumping back.

20 Excuse me.

21

22 CROSS-EXAMINATION

23

24 BY MS. HAMBURGER:

25 Q Mr. Cantilo, referring to the - when Mr. Mitchell walked you

1 through those criteria from the OIC Staff's hearing brief,
2 the Insurance Commissioner might weigh the evidence
3 differently than you or Mr. Mitchell does; isn't that right.

4 A Absolutely.

5 Q Now, you discussed with Mr. Mitchell this issue about
6 nonprofit corporations holding - whether nonprofit
7 corporations are charities or not. But whether or not a
8 corporation registers as a charity doesn't tell you the
9 answer of whether they hold assets in charitable trust, does
10 it?

11 A Not necessarily. That's right.

12 Q You testified that you've been involved in a number of Blue
13 Cross conversions. Do you think that Blue plans that are
14 planning on converting monitor earlier conversions in order
15 to determine what to do?

16 MR. MITCHELL: Objection. Leading.

17 JUDGE FINKLE: Overruled.

18 A Most definitely. I think - I mean I've made the observation
19 among our team that Premera seems to have been very well
20 prepared for this conversion and has learned a lot from the
21 preceding ones. And in fact, I think we've been told that
22 that's what they did.

23 Q (BY MS. HAMBURGER) In the Kansas transaction, did the
24 company attempt to dispute the calculations about potential
25 rate increases?

1 A That's correct.

2 Q And would a company looking at the Kansas transaction come
3 away with lessons about how to deal with that issue?

4 A Yes.

5 Q What lessons do you think a company would learn from the
6 Kansas transaction if they were to try and structure their
7 deal to deal with that potential rate issue differently?

8 MR. MITCHELL: Objection. Beyond the scope and
9 calling for speculation.

10 JUDGE FINKLE: Sustained.

11 Q (BY MS. HAMBURGER) You testified a minute ago that a company
12 could learn lessons by watching the deal in Kansas. What
13 would those lessons be that you were referring to?

14 A They fall in two or three categories. One is the manner in
15 which the transaction ought to be presented to the
16 regulators. Without meaning disrespect, I think that's not a
17 lesson Premera learned from the Kansas transaction.

18 Second is how to deal with what I think is often the
19 most important issue, which is the potential impact on the
20 insurance-buying public and on the insureds of the company.
21 I think that is a lesson that Premera has learned from the
22 Kansas transaction.

23 And then the third is preparation of the application
24 and the materials supporting the application and
25 documentation for the transaction.

1 Q In your experience with past conversions, is it unusual for a
2 company to claim that it's not a charity and doesn't have to
3 deliver fair market value?

4 A No, it's not at all unusual. I was trying to do a mental
5 count. I think of the 10 or so in which I've been involved,
6 it's been about half and half.

7 MS. HAMBURGER: Thank you.

8 JUDGE FINKLE: Other questions from Intervenors?

9 MR. MADDEN: No, your Honor.

10 MS. deLEON: Did you want to take a break now?

11 JUDGE FINKLE: About how long do you expect to be?

12 MS. deLEON: Probably 10 minutes for myself.

13 JUDGE FINKLE: Well, if you think that's a
14 realistic estimate, let's go ahead.

15

16 REDIRECT EXAMINATION

17

18 BY MS. deLEON:

19 Q Mr. Cantilo, is it necessary for your analysis that Premera
20 concedes it's a charity?

21 A Absolutely not.

22 Q Why not?

23 A Because the assumption that it has an obligation to transfer
24 its fair market value is dependent on two independent issues:
25 One, its representation in the documents, about which we've

1 spoken at length; and two, the operation of the Nonprofit Act
2 and the articles of incorporation.

3 Q And do you - in your opinion, is Premera obligated to
4 transfer fair market value of its assets?

5 A Yes.

6 Q Why? Where did you get that from?

7 A Well, first I think they came to the Commissioner saying that
8 that's what they would do. And I think if they want to do
9 something different, they ought to file a new application
10 that says, "We want to transfer 80 percent of our fair market
11 value. Would you let us convert then?"

12 But second, I think given the structure that it
13 elected, which is dissolving their current corporation, they
14 have to follow the articles of incorporation in their statute
15 and transfer all of their assets to nonprofit entities, and
16 that is the fair market value.

17 Q May distinction be drawn between the fair market value of the
18 restricted stock and the fair market value of Premera's
19 assets upon dissolution?

20 A Definitely. The stock, once restricted, by virtue of the
21 restrictions, will have its own fair market value, which is
22 different from the fair market value it would have if it were
23 not restricted.

24 Q Regarding the Commissioner's ability to construe the Holding
25 Company Act with regards to this conversion, is he bound at

1 all, in your opinion, by the Blue Cross/Blue Shield
2 Association restrictions?

3 A No.

4 Q In your opinion, can the restrictions of the Blue Cross/Blue
5 Shield Association be negotiated?

6 A Yes. Definitely. I think every one of the conversions with
7 which I'm familiar has resulted or included a negotiation.
8 And I don't think this one's an exception. I think we saw
9 originally that there could only be one board member for both
10 states put together. But now there can be a separate board
11 member for each state. So hopefully there can be progress
12 made on the divestiture schedule, the free vote allotment and
13 the other issues just in the same way.

14 Q The economic assurances that you testified to earlier, do
15 they eliminate the issues?

16 A The economic assurances with respect to the market impact
17 issue are in the province of the economists, the actuaries
18 and the Pricewaterhouse consultants. And I'm probably not
19 the best person to ask that question. But I think they
20 ameliorate it but they don't eliminate it because they don't
21 go far enough in time.

22 Q You testified that you agreed with Mr. Steel's --

23 A I think I testified that he agreed with us.

24 Q Oh, okay. Hold on.

25 A The precise point was that Mr. Steel and we interpreted the

1 application of the Nonprofit Act and the articles of
2 incorporation in the same way.

3 Q And how did Mr. Steel interpret those that agreed with you?

4 A I have a slide, if - if we have time for one more slide:
5 This is the specific paragraph from page 21 of Mr. Steel's
6 report, which concludes, as we did, that when you juxtapose
7 the articles of incorporation and the statute, it has to
8 distribute its assets to one or more nonprofit corporations
9 or entities.

10 Q When we talk about the restrictions on the assets, we're
11 talking about the restrictions between the fair market value
12 transferred between Premera as a nonprofit to the foundation
13 shareholder and not the public. Is that a correct
14 interpretation?

15 A That's correct. That's the transfer of the stock to the
16 foundations.

17 Q So did your analysis look beyond that as far as looking from
18 the sale of the stock from the foundation shareholder to the
19 public?

20 A No. That's a good point. The fact that the public will buy
21 unrestricted stock doesn't affect this issue because the
22 point is that the foundations will not be able to time the
23 sale of that stock. Whenever they can actually sell it, the
24 public will buy it unrestricted. But the price at which
25 they'll buy it will depend on the market at the time. And

1 that price - that is that time will be determined by the
2 restrictions.

3 MS. deLEON: No further questions.

4
5 RECROSS-EXAMINATION

6
7 BY MR. MITCHELL:

8 Q Your point in response to counsel's last question seems to
9 be, Mr. Cantilo, that because the foundations cannot time the
10 sale of all of their stock, that that's going to
11 detrimentally affect the value they can receive for it. Do I
12 understand you correctly?

13 A It may.

14 Q And --

15 A I can't predict. But it may.

16 Q And you were here for the testimony of the investment
17 bankers, who said that if you have a large shareholder that
18 does not have restrictions on how it disposes of the stock,
19 the value of that stock in the marketplace is going to be
20 depressed because of the lack of the restrictions. You heard
21 that testimony?

22 A I understood the testimony to be that it might, not that it
23 would.

24 Q You disagree with the investment bankers on this, do you not?
25 Is it not your opinion that the only appropriate restriction

1 on a foundation in the circumstances present here would be a
2 single hold-back period?

3 A I'm not an investment banker. But I do think, based on
4 experience in other transactions, that having a lock-up at
5 the beginning of the period, that is immediately following
6 the IPO, would allow the market to stabilize.

7 Now, I don't disagree that some divestiture schedule
8 might, in some circumstances, be perceived favorably by the
9 market. But I think there's no empirical evidence - and I
10 asked for that and was never provided empirical evidence -
11 for the proposition that the absence of a divestiture
12 schedule has an adverse impact on the stock value.

13 Q That may be, Mr. Cantilo, because nobody's ever had the
14 temerity to try it; isn't that correct?

15 A No, I don't know that that's the reason.

16 Q Certainly not in any Blue Cross/Blue Shield conversion has
17 there been a circumstance in which there's not been a
18 divestiture schedule associated with the disposal of stock;
19 isn't that right?

20 A I'm not aware of any, because I have advocated for the
21 absence of divestiture schedules. I just haven't been
22 successful.

23 Q As I understand it, you're hoping that Commissioner Kreidler
24 will be the instrument by which this proposition can be
25 tested.

1 A Oh, no. I haven't advocated that he push for the complete
2 elimination of divestiture schedule.

3 Q You appear to draw solace for your position from the articles
4 of incorporation of Premera which require that the assets of
5 the corporation upon dissolution be distributed to one or
6 more nonprofits. Correct?

7 A Well, I mentioned that as an independent reason, although
8 that's not what we based our report on. As I said earlier,
9 we make the assumption that that was an agreement.

10 Q And in the . . . First of all, the articles of incorporation
11 are subject to amendment by the board, are they not?

12 A Yes.

13 Q But let's assume that these articles apply. Is there
14 anything in the articles that suggests the application of a
15 fair value, a fair market value, or any other test to -
16 whether the assets are being appropriately distributed under
17 article 12?

18 A Well, I interpret the requirement that all of the assets be
19 distributed after the payment of debts to necessarily
20 encompass the fair market value of those assets. But the
21 words fair market value do not appear.

22 Q And there is no external test of fair market value here
23 beyond what you see as inappropriate restrictions on the
24 stock; isn't that right?

25 A By test, do you mean is there a provision that undermines the

1 value of the assets being conveyed?

2 Q There is no market that's determining anything in this - at
3 this point, is there?

4 A There is no market for the stock right now. That's correct.

5 Q And unless the stock is transferred to the foundations, the
6 foundations will have nothing; isn't that right?

7 A Well, that's a highly hypothetical question. But if there's
8 no transaction, I presume no foundations will be formed and
9 funded and, therefore, those foundations would have nothing.
10 The public would still have whatever value it derives from
11 the company's current form.

12 Q Which value you think stems from the fact that Premera is
13 owned by the public, doesn't it?

14 A What I had in mind is I think that . . . Well, I won't
15 quarrel with you.

16 Q I'm sorry?

17 A I will not quarrel with you. I think that that is a value,
18 yes.

19 Q Now, I don't believe that Premera's ever suggested that the
20 Blue Cross/Blue Shield Association has power to control what
21 the Commissioner chooses to do. Did you understand Premera
22 to be suggesting that?

23 A Well, indirectly. I think we've been told repeatedly that
24 things that we found objectionable and problematic in the
25 transaction were beyond our ability to challenge because they

1 were conditions imposed by the association without which it
2 would lose its mark, which would be a disastrous consequence
3 for the company.

4 Q So it comes down then not to the Blue Cross/Blue Shield
5 Association saying anything to the Commissioner, but whether
6 the Commissioner should impose conditions that the Blue
7 Cross/Blue Shield Association has said will result in loss of
8 the license. Isn't that what it comes down to?

9 A I don't see it that way.

10 Q Well, it is - it is unfortunately the case that the
11 consequences of that choice, should anybody guess wrong, will
12 be visited upon the subscribers of Premera and the people of
13 Washington and Alaska and not upon the consultants in this
14 case; isn't that right?

15 A Again, I don't think it has to go that way.

16 MR. MITCHELL: Nothing further.

17 MS. HAMBURGER: We have nothing.

18 MS. deLEON: Nothing further.

19
20 EXAMINATION

21
22 BY COMMISSIONER KREIDLER:

23 Q Mr. Cantilo, I would have to say that getting away from
24 economists and actuaries is --

25 A On behalf of the American Bar Association, such a rare

1 comment. Thank you.

2 Q Let me go to a question here. If you can tell me,
3 Mr. Cantilo, why you think the assurances should be extended
4 longer than two years?

5 A Well, that's probably a question better addressed by
6 Mr. Staehlin and the economists and, of course, Ms. Hunt, but
7 - PricewaterhouseCoopers. But as I understand the issue, two
8 years is not going to have been a long enough period of time
9 for the dust to settle, for lack of a more technical term,
10 and for you to be able to have ascertained the impact of the
11 transaction on the insurance-buying public and Washington.

12 Q There's been a fair amount of discussion about the role of
13 the Blues association. And it's come up in other testimony
14 as to some of the standards that they have and the lack of
15 having those delineated in such a way that you could turn to
16 a manual or a description of just exactly what they were. Is
17 that an indication to you that these conditions for a
18 conversion and its compatibility with the Blues association
19 are somewhat flexible?

20 A I believe that strongly. If you will indulge me. I can tell
21 you the CareFirst story because it's so illustrative of that
22 point.

23 Q Please do.

24 A The association believes strongly that it cannot seed board
25 representation. And so, for example, here you will get one

1 board representative for each of the two states. And it held
2 that position in the CareFirst transaction as well. When the
3 transaction was disapproved, the backlash was so severe that
4 the Maryland General Assembly passed a law that authorized
5 the General Assembly to appoint the majority of the CareFirst
6 board, which I think you will concede is fairly unusual.

7 The association's immediate reaction was to threaten
8 revocation of the license. And the General Assembly did not
9 relent. They insisted they would continue with their desire
10 to appoint the majority of the board, among other things.

11 The association did revoke the license and, in what I
12 thought was an extraordinary maneuver, sent the governors of
13 the three states involved a letter saying, "CareFirst is no
14 longer a Blue Cross/Blue Shield plan. We will soon tell you
15 who your new Blue Cross/Blue Shield plan will be."

16 But negotiations then ensued, at the end of which
17 CareFirst retained its Blue Cross/Blue Shield license and the
18 General Assembly gets to appoint I think five directors for
19 the company, which I don't think is a majority but it's very
20 close to the majority, far beyond the one they normally tell
21 you is the most they'll ever let you appoint.

22 Q Thank you. That is a good story.

23 A I think it depends on where you were sitting.

24 Q One of the questions that came up or comments that you made
25 was relative to the control that might be held by the - by

1 Premera if, in fact, there were restrictions on the voting of
2 the stock; is that correct?

3 A I'm sorry. Could you --

4 Q As long as the - as long as the stock that was held by the
5 foundations was restricted, that helped to assure the
6 position of the board and management of Premera?

7 A Yes. I think it does because the board is elected by
8 shareholders. But by virtue of the fact that the largest
9 shareholder here will not have a vote, for most practical
10 purposes, that means that the decisions normally made by that
11 shareholder will be made by way of what is called an
12 independent board majority; which guess what, it's the
13 current board of directors.

14 Q One of the issues that you also mentioned was the related to
15 the lack of - or perceived lack of due diligence on the part
16 of the Premera board to explore other alternatives to raising
17 capital, such as merger and acquisition; is that correct?

18 A That's correct. Yes, sir.

19 Q Out of curiosity, in your experience, would it mean that for
20 a corporation, that if they wanted to keep control, that, in
21 fact, by virtue of completing a conversion, they would be in
22 a stronger position to potentially have a stronger role if a
23 merger or acquisition were to subsequently occur?

24 A That can be the case. You mean if they become
25 publicly-traded first and then they become acquired?

1 Q Right.

2 A But that's not typically the case, even in those
3 circumstances. And I think we have examples of that. The
4 Trigon acquisition by Anthem which is just now under way is
5 exactly that kind of transaction. I think what you typically
6 see is that even in that context, the senior managers of the
7 company, the CEO, maybe the CFO end up leaving, leaving with
8 benefits, but leaving, because the resulting entity can
9 really only have one CEO and really only have one CFO. You
10 may see a transition period during which the senior
11 management team of the acquired company stays in place for a
12 year or two. But even then I think the senior management
13 team eventually does change and the board I think changes.

14 And once again, there are typically accommodations
15 where one or two board members of the acquired company may be
16 on the parent company's board. But in general, you typically
17 see most of the acquired company's board being disbanded at
18 the time of the acquisition.

19 Now, sometimes they keep the corporate entity and the
20 board may stay as the board of the subsidiary, but it doesn't
21 have the authority it did as the board of the parent in the
22 prior structure.

23 Q In the case of management and what I think would apply here
24 as kind of a golden parachute, would it be a stronger golden
25 parachute if they were to do a merger or acquisition as a

1 part of the conversion or to do it afterwards, after they've
2 converted to a public company?

3 A Well, based on my experience, far, far more lucrative after.
4 I think the senior managers and senior shareholders of
5 Trigon, for example, who were with Trigon up until the time
6 it was acquired by Anthem, have done far better by selling
7 themselves to Anthem after they were publicly-traded than
8 they would have done if they had sold directly to Anthem back
9 in '98, when they converted, if that's responsive to your
10 question.

11 Q It was. Thank you. I'm curious if after Premera became a
12 public company - and we certainly heard that there are
13 assurances that they would - they plan on remaining an
14 independent Washington corporation - but if there was an
15 offer from another company that was a very lucrative one
16 relative to the - for the stockholders, is it something that
17 could be essentially rejected out of hand by the board or
18 not?

19 A It depends on the circumstances. Under certain
20 circumstances, there is a lot of cases to which securities
21 lawyers call - refer to as the Revlon cases, which imposes on
22 the board the absolute duty to consider solely on price a
23 hostile tender offer. Now, the application of the Revlon
24 cases is relatively limited.

25 Even without the Revlon role, if the board receives a

1 bona fide offer to purchase the company, I think it has a
2 fiduciary obligation to evaluate and consider that offer
3 before rejecting it. I don't think it can just say, "We
4 never be sold."

5 Beyond that, it may not be within their control. If
6 the stock is publicly-traded, a party, especially a Blue
7 Cross licensee who's not subject to a 10 percent restriction,
8 could acquire enough stock over time to effectively start
9 getting control of the company. It couldn't acquire all of
10 the stock of the company. First of all, a lot will be held
11 by the foundations. And secondly, it's hard to acquire that
12 much stock quickly, even if you comply with the filing
13 requirements of the SEC. But over time, they can do that.
14 They would eventually be able to elect their own directors
15 and acquire control.

16 Q Wouldn't the restrictions on stock ownership apply?

17 A Not to a Blue Cross licensee. One of the magical things
18 about those restrictions is they don't apply to another Blue
19 Cross licensee. So in Anthem or WellPoint want to buy
20 Premera stock, they can buy as much as they want.

21 Q So given the assurances of management and the board of
22 Premera, what you're saying then is it might be outside of
23 their control to maintain the independence that they seek to
24 hold?

25 A That's correct. And I think that's - so even beyond the

1 mechanical reasons I've described, I think as a practical
2 force of market economics, that may be the case. Management
3 may decide on its own three years from now that they're
4 better off selling the company even if no one has made any
5 unabided offers.

6 MR. KREIDLER: Thank you very much.

7 THE WITNESS: Thank you, Commissioner.

8 MS. deLEON: No questions.

9 MR. MITCHELL: Couple of brief follow-up,
10 recognizing everybody's anxious to get to the break.

11 THE WITNESS: Especially me.

12 MR. MITCHELL: No doubt.

13
14 RECROSS-EXAMINATION

15
16 BY MR. MITCHELL:

17 Q With respect to the CareFirst situation or the fall-out from
18 the CareFirst situation, Mr. Cantilo, would you agree with me
19 that it was not a particularly happy set of circumstances
20 that led to the appointment of board members to the CareFirst
21 board by the Maryland assembly?

22 A I completely agree with you. I think that's the poster child
23 of what not to do in a conversion.

24 Q You don't really want to end up in a place where the
25 association strips the license, you have a crisis of coverage

1 for all the subscribers, multijurisdictional litigation, do
2 you?

3 A No.

4 Q With respect to board continuity and I guess entrenchment,
5 given that Premera as a nonprofit has a self-perpetuating
6 board, if the board were really interested in entrenchment,
7 it would remain as a nonprofit and never have to worry about
8 upstart shareholders; isn't that right?

9 A They would have a pretty tough time getting stock options and
10 some of the other benefits. But they could do that.

11 Q There was a question or two about the possibility of a
12 takeover of the company, Mr. Cantilo. There was in the
13 Form A documents a shareholder rights agreement that would
14 strengthen the ability of the board to fend off takeover -
15 potential takeover entities, was there not?

16 A Yes, there was.

17 Q And was it not at the insistence of the state's consultants
18 that that was taken out of the Amended Form A documents?

19 A We asked that it be removed, yes.

20 Q And with respect to any potential acquisition of Premera,
21 willing or unwilling, is it not the case that it would have
22 to be approved by the Commissioner?

23 A Absolutely. Unless the law changes, it would have to go -
24 undergo a Form A proceeding.

25 MR. MITCHELL: Thank you.

1 RECROSS-EXAMINATION

2

3 BY MS. HAMBURGER:

4 Q Mr. Cantilo, how many conversions have been followed by a
5 merger or acquisition?

6 A Boy, that's a hard question. I think there are only
7 currently three publicly-traded plans left. And by the time
8 the order is entered here, there'll probably be two. I think
9 the WellChoice - or rather WellPoint/Anthem merger will be
10 complete. Most of the conversions . . . Was your question
11 how many were followed by a public offering or --

12 Q How many conversions were followed by a merger or
13 acquisition?

14 A The vast majority. I can think of some that were not. But
15 the vast majority.

16 MS. HAMBURGER: Thank you.

17

18 REDIRECT EXAMINATION

19

20 BY MS. deLEON:

21 Q Mr. Mitchell just talked to you or asked you about the
22 shareholder rights agreement?

23 A That's right.

24 Q And why did you ask that that be removed?

25 A Well, it imposed on the foundations a variety of restrictions

1 which we thought were unjustified under the circumstances.
2 Some of it was replaced by a new agreement. But once again,
3 that agreement was improved as a result of our discussions as
4 the application has been amended.

5 MS. deLEON: Thank you. No further questions.

6 MR. MITCHELL: Quick follow-up to Ms. Hamburger's
7 question, Mr. Cantilo.

8
9 RECROSS-EXAMINATION

10
11 BY MR. MITCHELL:

12 Q Within the world of nonprofit Blues, there has been a
13 significant contraction, has there not?

14 A Are you asking me are there fewer nonprofit Blues than there
15 used to be or are they smaller?

16 Q Yes. There are fewer of them, are there not?

17 A Well, overall, the number of Blue Cross licensees has
18 diminished dramatically over the last couple of decades, from
19 162 to I guess we're at 41 right now.

20 Q And there's no assurance that if one remains nonprofit, one
21 will remain an independent Blue, is there?

22 A There's no assurance of almost anything. I am familiar with
23 a variety of Blue Cross plans who are firmly committed to the
24 nonprofit mission, like High Mark Independent, the
25 Massachusetts plan, the Minnesota plan, the North Dakota plan

1 and a variety of others. And as far as I can tell from my
2 observations and from having been involved in transactions
3 with them, they seem to be faring quite well.

4 Q Fared better than Maine and New Mexico and a few other plans;
5 is that right?

6 A As always, you can find good illustrations of what goes
7 wrong. And Maine and New Mexico are good illustrations.

8 MR. MITCHELL: Thank you.

9
10 RE-EXAMINATION

11
12 BY COMMISSIONER KREIDLER:

13 Q Are you aware of any transactions in a sale merger
14 acquisition conversion where there were conditions
15 prohibiting in this case post-conversion mergers or
16 acquisitions?

17 A No, I'm not. And I'm not sure how enforceable those would
18 be, given the federal securities laws. But assuming the
19 company goes public first, I'm not sure, Commissioner, that
20 you could, under state law, restrict the tradability of those
21 stocks. But . . . And I haven't actually thought about this
22 question so I probably ought to stop the wheels. But I can
23 conceive of other problems with doing that. You might be
24 putting the company at a pretty tough disadvantage if you did
25 that.

1 Q Relative to conversion, you're not aware of any restrictions
2 like that being proposed?

3 A Not of any long duration. There are lock-ups that you see
4 sometimes that prevent the company from selling its own
5 stock. And those have the effect of preventing an
6 acquisition because the majority of the stock is subject to
7 the lock-up. But those lock-ups are usually six, 12 months,
8 18 on the outside. I have not seen anything beyond that.

9 Q On the issue of if there were a post-conversion merger or
10 acquisition that took place and a new Form A having to be
11 filed, would it, in your experience, be as difficult as a
12 conversion from nonprofit to for-profit?

13 A In my experience, no. I - I have actual experience because I
14 was in both of the Trigon transactions. And the first was a
15 very difficult and cumbersome process, not unlike this one.
16 And the second, its acquisition by Anthem, was a matter of
17 weeks and not nearly as painful or contentious.

18 MR. KREIDLER: Thank you very much.

19 JUDGE FINKLE: Any follow-up?

20 MS. deLEON: No.

21 MR. MITCHELL: Let's take a break.

22 JUDGE FINKLE: Quick reality check and then we'll
23 take a break. Yes. Please step down. Thank you.

24 THE WITNESS: Thank you.

25 JUDGE FINKLE: What remains?

1 MS. deLEON: Your Honor, the OIC rests except for
2 Jim Odiorne's testimony. So we're basically through with our
3 witnesses.

4 MR. COOPERSMITH: And your Honor, the WSMA needs
5 to call Mr. Perna today because of his - accommodating his
6 schedule.

7 JUDGE FINKLE: Sure.

8 MR. MADDEN: And if there's time remaining, we
9 have Mr. Greenawalt available as well to round out the day.
10 He's also available Monday if there are some other
11 constraints.

12 JUDGE FINKLE: That's fine. Then do we have any
13 sense of the additional witnesses from the Intervenors?

14 MR. COOPERSMITH: Your Honor, the WSMA anticipates
15 taking up to 30 minutes with Mr. Perna.

16 JUDGE FINKLE: I'm sorry. Not the timing of him.
17 But I'm really looking ahead to Monday, just trying to
18 see . . . What I've hoped is Mr. Odiorne will get on in
19 comfortable time on Monday, giving the opportunity I
20 indicated I would give to Premera to prepare Monday evening.
21 And then we'd have his cross-examination on Tuesday and
22 potentially conclude. But tell me what you expect Monday.

23 MR. MADDEN: I believe that certainly the direct
24 examination of our remaining witnesses won't take the
25 morning. I would kind of expect the direct and cross, you

1 know, optimistically might be done by the noon break or, if
2 not, early in the afternoon.

3 JUDGE FINKLE: Anything further from Alaska on
4 this point?

5 MS. McCULLOUGH: No. I think we - at this point,
6 I'm . . . At this point, we have decided that we don't
7 anticipate calling any witnesses. But we would like to
8 reserve the right to notify, you know, either at the end of
9 the day or Sunday. And we can call them on Tuesday.

10 JUDGE FINKLE: Okay. Thanks. We'll go ahead and
11 take a break.

12 (Afternoon recess.)

13 JUDGE FINKLE: Please continue call your next
14 witness, please.

15 MR. COOPERSMITH: Thank you, your Honor. At this
16 time, the Washington State Medical Association calls
17 Bob Perna to the stand.

18 BOB PERNA, having been first duly sworn by the
Notary, testified as follows:

19
20 DIRECT EXAMINATION

21
22 BY MR. COOPERSMITH:

23 Q Good afternoon. Could you tell us your name and your
24 occupation for the record, please.

25 A Yes. My name is Bob Perna. I'm the Director of Healthcare

1 Economics for the Washington State Medical Association.

2 Q And how many years have you spent in the healthcare field?

3 A 36 years.

4 Q And what type of work have you done in that field?

5 A I have - for 10 years, I was the supervisor of a physician
6 relation department for a Blue Cross/Blue Shield firm. I
7 have been a billing manager for hospital settings. For
8 six years, I managed a private medical practice. I've worked
9 in billing management for a nursing home based in Tacoma and
10 also here in Seattle for Virginia Mason Medical Center and
11 also for a group of community clinics here in Seattle, the
12 Puget Sound Neighborhood Health Centers, for four and a half
13 years.

14 Q Thank you. And how many years have you spent with the
15 Washington State Medical Association?

16 A 12 years.

17 Q And have you filed reply direct testimony in this case?

18 A Yes, I have.

19 Q And do you adopt that testimony?

20 A Yes, I do.

21 MR. COOPERSMITH: Your Honor, at this time the
22 WSMA moves to admit Intervenors' Exhibit 101 into the record?

23 JUDGE FINKLE: Anticipating what may be asked,
24 this is the revised testimony in light of the redaction.

25 MR. COOPERSMITH: Yes, in light of the Court's

1 ruling.

2 MS. EMERSON: No objection. However, just for
3 point of clarification, I believe Mr. Coopersmith referred to
4 Exhibit 101. And it's my understanding, based on their
5 exhibit list, that Exhibit I-100 should be the pre-filed
6 responsive testimony from Mr. Perna.

7 MR. COOPERSMITH: There is no responsive testimony
8 from Mr. Perna. He gave direct testimony. Our records said
9 100. But whatever the revised direct testimony is from
10 Mr. Perna, that's what we move to admit into the record.

11 MS. EMERSON: I didn't mean revised. But it was
12 I-100.

13 MS. deLEON: No objection.

14 JUDGE: 100 admitted subject to the numbering
15 being corrected.

16 MR. COOPERSMITH: Thank you, your Honor.

17 Q (BY MR. COOPERSMITH) Mr. Perna, can you tell us what the
18 purpose of the WSMA is?

19 A Essentially it's to advocate on behalf of physicians and
20 patients.

21 Q And does WSMA play a role in promoting public health?

22 A Yes, we do. Through our foundation, the Washington State
23 Medical Education Research Foundation, we have a number of
24 initiatives that we've conducted. We have an initiative on
25 appropriate utilization of antibiotics, a pain management

1 manual to aid physicians in treating pain patients, and also
2 a - what was that - oh, a heart surgery program that we did
3 to assist physicians in improving surgical outcomes for heart
4 patients.

5 Q And can you tell us about the jobs you've held at the WSMA.

6 A I've had three separate positions at the WSMA. The first was
7 a reimbursement specialist. And in that role, I was the - I
8 would do analysis of reimbursement issues and would inform
9 physicians of their rights and responsibilities.

10 And the second position I had was as associate director
11 of professional affairs. And I was essentially the lead
12 resource on insurance issues for physicians in the state.

13 And my current position is that of the director of
14 healthcare economics. We've expanded upon that. We offer
15 additional information and publish articles and develop
16 reference tools for physicians and practice administrators to
17 use.

18 Q And do you have any responsibility in communications between
19 the WSMA and physicians in our state?

20 A Yes, very much so. Actually on a daily basis with
21 physicians, practice administrators and their billing staff.

22 Q And what is the relationship between the WSMA and the health
23 insurance carriers?

24 A We work very closely in trying to resolve issues and try to
25 collaborate on projects whenever possible.

1 Q Can you tell us what the medical practice data project is?

2 A Medical practice data project was an initiative launched by
3 the Washington State Medical Association to address concerns
4 that we were hearing about threats to the viability of
5 physician practices, whether or not they'd be able to keep
6 their practices open.

7 Q And what was your role in that study?

8 A I was the project manager. I coordinated the efforts of the
9 two universities that we engaged to conduct the project for
10 us.

11 Q And what were the findings of that study?

12 A Two essential findings. One was that the marketplace in the
13 healthcare industry is deeply flawed. And further, it was
14 aggravated by insurance industry practices. And typically
15 those practices had to do with low payment that were - by
16 insurance companies that were essentially inadequate to meet
17 the costs of providing care, delays in payment, denials of
18 payment --

19 MS. EMERSON: I'm going to have to object at this
20 point. I believe this testimony is getting into the area of
21 expert testimony that was excluded by your Honor.

22 MR. COOPERSMITH: Your Honor, he's, in fact, a
23 project manager of this study and he will soon testify to how
24 the study findings coincide with the personal experience he's
25 had with physicians.

1 JUDGE: Overruled.

2 Q (BY MR. COOPERSMITH) You may finish.

3 A Thank you.

4 Q You mentioned the inadequate reimbursement and delayed
5 payments or -- Were there any other --

6 A Delayed payments, denial of payments, and then the overall
7 administrative burden that medical practices incur in dealing
8 with the healthcare industry.

9 Q And when were the findings issued?

10 A In 2002.

11 Q And is it your experience in your daily contact with
12 physicians that the problems identified in the study still
13 exist in our state?

14 A Yes. From conversations with physicians and practice
15 managers, yes.

16 Q And would you characterize those concerns as isolated or
17 widespread?

18 A As widespread across the state.

19 Q And have physicians expressed their concerns to you about
20 Premera's proposed conversion?

21 A Yes. It is an issue of deep concern for them. They are
22 concerned that essentially the conversion would actually
23 worsen the difficult system that we're in right now.

24 Q And when you characterize the frequency of how often you hear
25 those concerns? Would that be frequently or infrequently?

1 A Frequently.

2 Q All right. You mentioned that one of the findings in the
3 study and the current problems is administrative burden from
4 health insurance practices. You've heard Premera state that
5 it no longer requires authorizations and now has a voluntary
6 benefit advisory; is that right?

7 A That is true. But there are still concerns about the benefit
8 advisory, essentially the difference being that the benefit
9 advisory doesn't provide any guarantee of payment. So a
10 medical practice can go through the exercise of obtaining the
11 advisory but again not be assured that there would be any
12 payment in that situation. Also, there's no indication as to
13 how long it will take to get that benefit advisory turned
14 around from the time of submission to the response. And
15 ultimately, as I say, since there's no guarantee of payment,
16 ultimately, you know, Premera could deny the payment.

17 Q And does that fact make the voluntary benefit advisory - how
18 does it compare with the requirement for prior authorization
19 that Premera used to have?

20 A It's a bit too soon . . . It's just fairly recently been
21 rolled out so it's a bit too soon to tell. However, it's -
22 from what - from discussions that I've had with physicians
23 and practice managers, there is some skepticism as to whether
24 or not this would be beneficial for medical practices or if
25 it's simply a procedural change that would be more beneficial

1 to Premera.

2 Q Did the previous requirement for prior authorization come
3 with a guarantee of payment from Premera?

4 MS. EMERSON: I'll object. Foundation.

5 JUDGE FINKLE: If you have knowledge, you may
6 answer.

7 A I'm not sure.

8 Q (BY MR. COOPERSMITH) Do you know the question?

9 A Would you repeat it.

10 Q Sure. The question was whether - did the previous process
11 that Premera used of prior authorization, did that come with
12 a guarantee of payment?

13 A I don't believe it did.

14 Q And Premera also states that it no longer requires referrals.
15 Are you aware of what the referral situation is like in
16 Washington state for Premera?

17 A Yes. It has improved. But the need for referrals has not
18 gone away entirely with Premera. And reviewing the Premera
19 website, there are still situations in which a referral is
20 required or recommended.

21 Q And did you hear Dr. Collins's testimony yesterday when he
22 expressed his concern about coverage decisions and where
23 they're being made by Premera?

24 A Yes.

25 Q And what has your experience been where those coverage

1 decisions are being made now by Premera?

2 A Both what I have heard from physicians and practice
3 administrators is consistent with what Dr. Collins had
4 reported, which is that some decisions are - particularly in
5 Eastern Washington are no longer made at the - in the Spokane
6 area. They are made at the Premera headquarters in Mountlake
7 Terrace.

8 Q And what are the terms that Eastern Washington physicians
9 have about decisions being made not locally but at the
10 Premera headquarters?

11 A Well, again, I think the concern is that this would - if this
12 were to become essentially - if Premera were to be acquired
13 and become an out-of-state - by an out-of-state carrier, that
14 the situation would worsen beyond that, that there would not
15 be healthcare decisions made locally, at the local level, and
16 responsive to the needs of Washington patients.

17 Q Have Washington physicians expressed frustration in their
18 current dealings with out-of-state carriers to you?

19 A Yes, they have.

20 Q And what sort of concerns were they?

21 A Well, essentially the fact that there is a - there's no way
22 of - requirement that there be a focus on improving care,
23 that the decision-making would be further removed, and there
24 wouldn't be any - be less direct contact with the
25 organizations and the individuals making those decisions.

1 Q And would you characterize that concern by WSMA members as
2 being about an out-of-state acquisition of Premera being a
3 large concern or a small concern?

4 A I would say it's a substantial concern, yes.

5 Q All right. And you also mentioned that both the study and
6 your experience find physician concern over claims payment.
7 You are aware that Premera stated that it pays clean claims
8 quickly; is that correct?

9 A That's correct. That's their position. Again, the devil
10 being in the details, the concerns being as to who makes the
11 decision as to what a clean claim is; how - what is the
12 timeline for the adjudication of those claims, concerns about
13 denials of those claims - you know, the claim could be
14 accepted but ultimately denied - and also whether or not a
15 claim is paid in its entirety; if it's paid below the rate
16 that was expected or agreed upon, whether that would create
17 further work for the physicians in having to appeal after the
18 fact.

19 Q And what is your experience with physicians when they feel
20 that a claim has been either wrongly denied or underpaid?

21 A Again, to have to appeal claims creates even further
22 administrative burden on practices to - to pursue that,
23 invest more time and man-hours in trying to address those
24 things. So very often it's a situation that's viewed as
25 being futile to actually even spend more time on that.

1 Q And in the concerns that physicians have expressed over the
2 proposed Premera conversion, have they told you about any
3 specific concerns regarding Premera contract negotiations?

4 A Again, we get the same sort of sense of futility. I think
5 there's - the sense is and I think we've heard in previous
6 testimony from Premera that the majority - the vast majority
7 of their contracts are not negotiated. They're standard
8 contracts. So again, I think that physicians have a sense
9 that there is futility in even attempting to try to negotiate
10 these practices unless they have a huge market share in their
11 area, market share of patients. So ultimately that's viewed
12 as a huge imbalance of power between the physicians and
13 Premera.

14 Q But how do physicians perceive the conversion affecting that
15 balance of power? What have they conveyed to you?

16 A What they've communicated to me is that they are concerned
17 that it would actually worsen the situation. So they have
18 fear that they would have even less leverage within the
19 marketplace and even less ability to negotiate contracts.

20 Q All right. And Mr. Perna, you have been here when Premera
21 has boasted about its new care facilitation program; is that
22 correct?

23 A Correct.

24 Q And can you tell us if physicians have discussed that program
25 with you?

1 A Yes, they have.

2 Q And are there concerns about that, Mr. Perna?

3 A Yes, there are. The concern with care facilitation is that
4 whether or not it's essentially sort of a code for further
5 medical necessity requirements in treating patients. Would
6 there be more restrictions that would be placed on care?
7 Would there be - create even further administrative burdens
8 created in order for the physicians to render what they
9 consider to be thorough and proper care in the care of their
10 patients? And --

11 Q Is there any concern about the motive behind care
12 facilitation by Premera?

13 A Well, I think the stated reason is for cost control. But
14 again, I think the concern is that it would be more of a
15 control over the caregiving relationship and really would be
16 more of a - maybe a cost savings for Premera rather than
17 facilitation of care actually.

18 Q And have physicians ever told you how reimbursement affects
19 patient care in this state?

20 A Mm-hmm. Yes, they have.

21 Q And can you tell us more about that, Mr. Perna.

22 A Well, I think in two broad areas, the concern has to do with
23 the effect that it has on the sickest and the poorest of the
24 patients. If the payment that the insurer makes Premera or
25 others does not keep up with the cost of actually delivering

1 the care, the concern is that this will further impede the
2 ability of physician practices to take care of the uninsured
3 and the underinsured in their practices and would actually
4 exacerbate that situation.

5 Q Well, how is that Premera's fault? Shouldn't the government
6 be, you know, paying physicians and hospitals more for the
7 care that they render to the poor?

8 A Yes. I think certainly the government entitlement programs
9 such as Medicare and Medicaid should pay more. But I think
10 it's sort of - it's not something that we have any direct
11 control over.

12 Q Is there something in this equation that physicians feel they
13 do have control over?

14 A Well, ultimately I think the issue is that what we're really
15 concerned with again is the issue being one of conversion, is
16 that whether or not that would ultimately make the situation
17 I just described, would actually worsen that situation, and
18 that the conversion itself would actually further drive down
19 the reimbursement as Premera's focus would be more on profit
20 for its shareholders.

21 Q And have physicians expressed concern about what happens when
22 - to emergency rooms when the primary care physicians are
23 unable to see the uninsured or underinsured?

24 A Sure. That is certainly a downstream effect. As those
25 sicker patients and poorer patients are not able to be seen

1 within private medical practices, then out of necessity, I
2 think their care reverts to emergency rooms as those patients
3 direct themselves there since they don't have any direct
4 access.

5 Q And on the issue of access, Mr. Perna, have you seen the
6 effect that reimbursement has in this state on patient access
7 to care?

8 MS. EMERSON: Objection. This is clearly calls
9 for testimony within the purview of that of an expert.

10 JUDGE FINKLE: Repeat the question.

11 MR. COOPERSMITH: The question, your Honor, was
12 whether, in his personal experience, he has seen the impact
13 of reimbursement on physicians' ability to give care and
14 access to care.

15 JUDGE FINKLE: Overruled.

16 Q (BY MR. COOPERSMITH) You may answer the question.

17 A Thank you. What we have seen is that it's very difficult.
18 You know, in dealing with physicians and practice
19 administrators, the recurrent things that we hear are that
20 they're having greater and greater difficulty attracting
21 physicians to practice in the state of Washington and the
22 recruitment issue. We're seeing that the physicians that are
23 coming out of medical school have debt loads that are in the
24 neighborhood of - I think last statistic I've seen, about
25 \$135,000. So those physicians, naturally they are looking

1 for, you know, the best possible financial arrangements that
2 they can. And unfortunately Washington is not able to
3 participate - compete in that environment. So there's
4 difficulty in recruitment.

5 There's difficulty then in retaining physicians then
6 who again are being lured away by better financial
7 arrangements to other cities. And ultimately the last thing
8 that we see are physicians that typically in past years would
9 have stayed in practice for longer periods of time are being
10 - are looking at retirement and retiring earlier than they
11 have in past years.

12 Q Have physicians expressed to you concerns about how Premera's
13 conversion might affect the coverage that they offer to their
14 patients?

15 A Well, essentially . . . Could you restate that.

16 Q Sure. Have physicians expressed concern to you about how
17 Premera's conversion might affect Premera's decision about
18 what coverage it offers to its enrollees?

19 A Okay. Thank you. Well, I think largely what we are
20 concerned with is Premera's presence in the marketplace.
21 There is a big concern that if Premera were to become a
22 for-profit entity, that it would no longer be offering
23 coverage in areas where it's - where it's profitable. I
24 think we've seen that Premera has withdrawn from the
25 individual market and it was an understandable decision that

1 it was an arena that needed - market that needed regulatory
2 reform. However, it's - I think the point is that Premera's
3 withdrawal did precipitate a collapse within that market.

4 MS. EMERSON: Objection. Your Honor, this is
5 within the scope of your ruling.

6 JUDGE FINKLE: Strike the last sentence. That's
7 stricken.

8 MR. COOPERSMITH: The last sentence is stricken.

9 Q (BY MR. COOPERSMITH) What was the effect of the Premera
10 withdrawal on physicians - on patients seeking care and
11 physicians' ability to provide that care?

12 MS. EMERSON: Same objection, your Honor.

13 JUDGE FINKLE: Sustained in that form.

14 Q (BY MR. COOPERSMITH) Did physicians express to you any
15 concern at the time about their ability to provide care to
16 patients who had been in the individual market?

17 A What has been reported to me was that they were unable to see
18 those patients. And again, as I alluded earlier, they -
19 those patients would wind up seeking care in emergency rooms.

20 Q All right. And let's turn now to the subject of membership
21 support for the WSMA's opposition to the Premera conversion.
22 Can you tell us how the WSMA reached the decision to oppose
23 the Premera conversion?

24 A Sure. Of course. The WSMA sets policy through its house of
25 delegates. And that's a process that convenes once a year.

1 It has representation from all specialties across the state
2 and all geographic areas. The contingent is about 220
3 physicians. So there was a vote at the 2002 house of
4 delegates I believe it was.

5 Q And what was the outcome of that vote?

6 A The outcome of that was to oppose the Premera conversion.

7 Q And what - by what margin did that vote carry?

8 A It was carried, I understand, by - well, by a unanimous vote.

9 Q And how often is there a unanimous vote on a major policy
10 decision by the house of delegates?

11 A That's actually a very rare occurrence.

12 Q And is the membership in the WSMA voluntary or obligatory?

13 A It's actually entirely voluntary. The WSMA's membership has
14 actually reached an all-time high, over 9,000 physicians. So
15 we certainly view ourselves as representative of the
16 physician marketplace. And ultimately I think that's further
17 evidence of the fact that, with increasing membership rolls
18 within the WSMA, has supported the WSMA's positions including
19 our opposition to the conversion.

20 Q And have physicians expressed their objection to the WSMA's
21 opposition to the Premera conversion to you?

22 A No, not to me.

23 Q Have they expressed any other sentiment to you about the
24 conversion?

25 A Well, just essentially, again, as I referenced earlier, that

1 there is concern about the conversion worsening the
2 situations and that - and actually as problematic as our
3 healthcare market has been shown, that the conversion would
4 actually make things worse.

5 Q And Mr. Perna, were you paid any extra for the work that
6 you've done on this case?

7 A No, I was not.

8 Q Do you wish . . . Were you paid any extra for your testimony
9 here today?

10 A No, I was not.

11 MR. COOPERSMITH: No further questions of this
12 witness at this time.

13 JUDGE FINKLE: Do you want to go ahead?

14 MS. deLEON: We have no questions.

15 MS. EMERSON: Thank you, your Honor. Good
16 afternoon, Mr. Perna. My name is Ramona Emerson.

17

18 CROSS-EXAMINATION

19

20 BY MS. EMERSON:

21 Q Mr. Perna, you testified that a purpose or the purpose of
22 WSMA is to advocate on the basis of physicians and patients;
23 is that right?

24 A On behalf of physicians and patients.

25 Q And how many nonprovider members are there that are part of

1 the WSMA?

2 A Well, say that - restate that, please.

3 Q Are all of the members of the WSMA providers?

4 A Yes. They are either physicians or physician assistants.

5 Q And there are no other members other than the physicians and
6 physicians assistants?

7 A That is correct.

8 Q Thank you. You testified in response to some questions by
9 Mr. Coopersmith about a study in which it was concluded that
10 the marketplace is flawed; is that right?

11 A That is correct.

12 Q Now, one of the items that you identified was administrative
13 burdens regarding health plans; is that correct?

14 A That is correct.

15 Q And that study focused on health plans in general?

16 A Yes, it did.

17 Q Not on Premera in particular?

18 A No. On the entire marketplace.

19 Q You also provided some testimony this afternoon regarding
20 Premera's claims payments. And you responded to a question
21 by Mr. Coopersmith concerning Premera's statistic of paying
22 95 percent of clean claims on time or within 30 days; is that
23 right?

24 A Yes, I did.

25 Q And you had some testimony about --

1 MR. COOPERSMITH: Objection to the
2 characterization of the question and the testimony but . . .

3 JUDGE FINKLE: I think he agreed with the premise.

4 MR. COOPERSMITH: Right. But she was assuming a
5 fact that wasn't in evidence.

6 JUDGE FINKLE: Right. But for efficiency, let's
7 move on. I'll overrule the objection.

8 Q (BY MS. EMERSON) And you included some other testimony about
9 Premera's claims payment; is that right?

10 A That's correct.

11 Q Did you personally study the timeliness of Premera's claims
12 payments?

13 A No. That was information reported to me by physicians and
14 practice administrators.

15 Q So you have no personal direct knowledge, do you?

16 A No.

17 Q Now, you also testified about Premera's care facilitation
18 programs; is that right?

19 A Right.

20 Q Now, were you here for Dr. Chauhan's testimony about
21 Premera's care facilitation programs?

22 A Yes, I believe I was.

23 Q Now, you said that there are some physician concerns that
24 these programs might be code for medical necessity; correct?

25 A Correct.

1 Q You heard Dr. Chauhan testify that Premera's care
2 facilitation programs are entirely voluntary; isn't that
3 right?

4 A Yes. That's correct.

5 Q In fact, Dr. Chauhan stated that Premera came up with an
6 approach that was not a, quote, "Mother, may I" approach;
7 isn't that right?

8 A That's correct.

9 Q Dr. Chauhan also testified that those programs follow an
10 approach that purposefully intends not to interfere with the
11 physician/patient relationship; isn't that right?

12 A That may be the intention, but it is not consistent with what
13 I'm hearing from physicians and practice administrators.

14 Q Well, Mr. Perna, you testified that there were some current
15 concerns that this "Mother, may I" approach could occur;
16 isn't that right?

17 A Correct.

18 Q Do you have some data today to support the position that
19 Premera is actually using a "Mother, may I" approach in
20 connection with its care facilitation programs?

21 A Given the fact that the program is so new, no, I do not have
22 any data at this time.

23 Q Now, you also testified about challenges with respect to
24 physician recruitment and physician exodus in the state of
25 Washington?

1 A Correct.

2 Q Mr. Perna, were you here for Dr. McCarthy's testimony?

3 A I - I was - I may have been in and out of the room, but I was
4 not paying attention to his content.

5 Q So you didn't hear Dr. McCarthy testify about the net
6 increase in the number of physicians in Washington state in
7 recent years?

8 A I did not hear that.

9 Q And you didn't hear Dr. McCarthy's testimony about the net
10 increase in physicians in Eastern Washington in recent years?

11 A I did not hear that testimony, so I couldn't respond.

12 Q Did you hear that Dr. McCarthy based his data on AMA data
13 concerning physicians within the state of Washington?

14 A Again, I was not here to hear that.

15 Q Let's talk a little bit about your pre-filed testimony.
16 Could you please get or place Exhibit I-100 in front of you.

17 A That is the revised direct testimony?

18 Q Yes, please.

19 A I have it.

20 MS. EMERSON: Your Honor, may I approach the
21 witness?

22 JUDGE FINKLE: You may.

23 Q (BY MS. EMERSON) Now, Mr. Perna, I understand that you are
24 the director of healthcare economics for the WSMA; is that
25 right?

1 A That is correct.

2 Q You're not trained as an economist, are you?

3 A No, I'm not.

4 Q You don't hold any degrees in economics?

5 A No, I don't.

6 Q Is your undergraduate degree in psychology?

7 A Yes.

8 Q Now, Mr. Perna, I understand from your testimony that you
9 have some views about the strength of Premera's competitors
10 in the state of Washington. Is that right?

11 A Correct.

12 Q Can you please look at paragraph 28 of your pre-filed direct
13 testimony.

14 A I have it.

15 Q Now, in paragraph 28, you - you indicate that CIGNA isn't
16 really a strong competitor to Premera; is that correct?

17 A Correct.

18 Q Can you please open exhibit - Intervenors' Exhibit I-103,
19 please, and turn to - it's page 3. And this is an excerpt of
20 Exhibit I-103 with pages for the carriers that I'm going to
21 examine you on.

22 A Okay.

23 Q Now . . . Oh, I'm sorry. This is page 4, CIGNA. So you
24 don't think that CIGNA is a strong competitor. Now, the
25 Intervenors' exhibit of membership profiles of Washington

1 healthcare plans indicates that for the year 2002, CIGNA's
2 commercial enrollment in the state of Washington was 180,000
3 lives; is that correct?

4 A That is what it says.

5 Q Is 180,000 an insignificant number to you?

6 A I don't know how to answer that.

7 Q Yes or no? Is 180,000 lives, is that an insignificant
8 amount of coverage in the state of Washington by CIGNA?

9 A You asked me about the number, not the number of covered
10 lives. No, I wouldn't characterize it as insignificant.

11 Q And let's look at paragraph 29 of your pre-filed direct
12 testimony. In paragraph 29, you state that you don't think
13 that Aetna is a formidable competitor of Premera's, do you?

14 A That's correct.

15 Q Now, can you please look at again Exhibit I-103 at page 3 and
16 take a look at the Aetna data.

17 A Mm-hmm. I have it.

18 Q And here in the Intervenor's exhibit, Aetna is identified as
19 having, for its commercial enrollment, 510,733 members. Did
20 I read that correctly?

21 A Yes, you did.

22 Q And with respect to the Washington specific program
23 enrollment, which appears to be the government-sponsored
24 membership, Aetna has 39,802 lives. Did I read that
25 correctly?

1 A It's a little muddy, but it appears to be the number.

2 Q Now, by my math, that would be 550,533 covered lives. Does
3 that number appear to be an insignificant number of covered
4 lives by Aetna in the state of Washington?

5 A I would not characterize that as insignificant.

6 Q Let's take a look at paragraph 31 of your pre-filed direct
7 testimony. Now, in paragraph 31, you state that another ploy
8 that Premera uses to exaggerate the level of competition is
9 to mention PacifiCare. And then you go on to say that
10 PacifiCare is only in a limited market because it only offers
11 Medicare managed care coverage; is that correct?

12 A Mm-hmm. That's my understanding.

13 Q Please look at page 5 of Exhibit I-103, please.

14 A Okay. I have it.

15 Q Now, here we do see that PacifiCare, as of the end of 2002,
16 had I think for Medicare 58,056 members. Is that correct?

17 A That is what it says.

18 Q And then in total for the government-sponsored programs,
19 PacifiCare had 85,087 lives. Did I read that correctly?

20 A That would be the sum of the Medicare, PEBB and the federal
21 employees? Is that . . . I'm trying to follow you.

22 Q The 85,080 lives. Correct. The sum of the PEBB, Medicare
23 and federal employees.

24 A That is what it says.

25 Q Now, for PacifiCare's commercial enrollment, the Intervenor's'

1 exhibit identifies 132,834 commercial members; is that
2 correct?

3 A I'm sorry. What paragraph are you on?

4 Q This would be at the top of the PacifiCare data under
5 "Washington Commercial Enrollment Summary."

6 A I see it.

7 Q Do you see a total of 132,834 lives?

8 A Yes, I do.

9 Q So PacifiCare does business in the state of Washington in
10 more than just the Medicare line of business; isn't that
11 correct?

12 A It would appear.

13 Q Please look at paragraph 32 of your pre-filed direct
14 testimony. Now, here you claim that Premera exaggerates the
15 competitive climate by claiming it must compete with
16 companies that are not actually insurers. Did I read that
17 correctly?

18 A Yes, you did.

19 Q You then list PHCO as an example of a company that is not an
20 insurer. Were you here yesterday for Dr. Collins' testimony?

21 A Yes, I was.

22 Q Did you hear Dr. Collins say that five percent of his
23 patients were insured by PHCO?

24 A I think he characterized that as an extremely small portion
25 of the number of patients within his practice.

1 Q I'm sorry, Mr. Perna. That wasn't my question. The question
2 was whether he testified that five percent of his patients
3 were, in fact, insured by PHCO.

4 A I don't remember the exact percentage.

5 Q Do you disagree with Dr. Collins' characterization of PHCO as
6 an insurer?

7 MR. COOPERSMITH: Your Honor, counsel is
8 testifying. That was not the testimony yesterday. It's
9 assuming facts not in evidence.

10 JUDGE FINKLE: If it matters, I'll look back. I
11 can't recall without doing that. Can you ask the question
12 differently?

13 MS. EMERSON: I can. Thank you, your Honor.

14 Q (BY MS. EMERSON) Would you - do you disagree with the
15 characterization that PHCO is an insurer?

16 A I'm not - still not following your point.

17 Q Well, Mr. Perna, do you view PHCO as an insurer?

18 A Not according to my testimony, no. I think I've said it's
19 not actually an insurer.

20 Q So if Dr. Collins did, in fact, testify that PHCO was an
21 insurer that insured five percent of his patients, would you
22 disagree with his characterization that PHCO is an insurer?

23 MR. COOPERSMITH: Asking for the witness to
24 speculate.

25 JUDGE FINKLE: Overruled.

1 A My sense is that Dr. Collins was characterizing insurance in
2 a very broad context as a pay --

3 Q (BY MS. EMERSON) I'm sorry, Mr. Perna. My question simply
4 called for a yes or no answer. We're on a time clock this
5 afternoon, so I'd appreciate it if you could just limit your
6 answers to yes or no if that's what the question calls for.

7 A I honestly don't know how to answer that yes or no.

8 Q So you can't tell us one way or another whether you would
9 agree or disagree with that characterization?

10 MR. COOPERSMITH: Objection. Asked and answered.

11 JUDGE FINKLE: Sustained.

12 Q (BY MS. EMERSON) Mr. Perna, can you tell us, are you
13 familiar with the "Association of Washington Healthcare Plans
14 Membership Profiles" that is Exhibit I-103?

15 A Yes, I am.

16 MS. EMERSON: At this time, Premera offers Exhibit
17 I-103 into evidence.

18 MR. COOPERSMITH: No objection.

19 MS. deLEON: No objection.

20 JUDGE FINKLE: Admitted.

21 Q (BY MS. EMERSON) Mr. Perna, you've stated that fostering
22 positive relations with healthcare insurance companies has
23 been a key goal of yours throughout your tenure at the WSMA.

24 A Mm-hmm.

25 Q Given this goal, I take it that you are familiar with the

1 relationships between health insurance companies and the
2 WSMA.

3 A Yes.

4 Q Are you then familiar with Premera's efforts over the last
5 few years to reach out to the provider community and the WSMA
6 in particular?

7 A Could you be more specific about reaching out?

8 Q Efforts to contact the WSMA leadership, work with the WSMA on
9 initiatives.

10 A I would be familiar with that, yes.

11 Q And do you believe that Premera's efforts in this area have
12 been genuine?

13 A It's hard for me to say. I don't know.

14 Q Do you believe that Premera's efforts in this area have been
15 phony?

16 A Again, I'm having difficulty with answering that question as
17 to whether or not . . . I mean towards what end? I mean
18 it's a difficult - it calls for me to understand what their
19 motivations might be. I don't know how to respond to that.

20 Q Well, from your perspective, I guess how do you define the
21 term genuine?

22 A In this particular instance or in the general literal meaning
23 of the word?

24 Q In this particular instance.

25 A All right. In this particular instance, if - you're asking

1 me what is the motive of Premera to reach out to physicians
2 and to improve communications?

3 Q Well, in terms of what you've observed when it comes to
4 Premera's efforts to work with the provider community and
5 work with the WSMA, do they appear to be genuine to you?

6 A In that context, I'll say yes.

7 Q I'm sorry. That was a yes?

8 A Yes.

9 Q Thank you. You've spoken with us today about the
10 difficulties to providers resulting from reimbursements that
11 are too low. Isn't the real problem here low government
12 reimbursement levels?

13 A No. I don't think so.

14 Q Well, aren't purchasers of commercial insurance products
15 forced to subsidize physicians for low government
16 reimbursements?

17 A How do you mean subsidize in this situation?

18 Q Well, looking for higher compensations on - from the
19 commercial providers to compensate for low reimbursements
20 from government-sponsored programs.

21 A No, not entirely. My sense is that that would - that seems
22 to imply that there is only one single root cause for
23 physician practices to seek higher reimbursement from private
24 insurance and that is solely due to the fact that there is
25 low payment rates on government programs. That's a facet of

1 the problem, but that's not entirely the problem at all.

2 Q So there are other - other parts to the story.

3 A Correct.

4 Q Don't skyrocketing malpractice premiums also drive physician
5 costs?

6 A That's part of their overhead expenses, yes.

7 Q Isn't efficiency and administrative simplification something
8 that both providers and insurance companies need to strive
9 for?

10 A Yes.

11 Q Are you familiar with Premera's efforts to improve
12 administrative simplification for providers?

13 A Yes.

14 Q Mr. Perna, is Mr. Aaron Katz the expert witness on behalf of
15 the WSMA and the other Intervenors in this matter?

16 A I'm not clear on your question. Is he the expert witness?

17 Q Is he an expert witness on behalf of the WSMA and the
18 Intervenors?

19 A I don't know.

20 Q Do you know Mr. Aaron Katz?

21 A Yes, I do.

22 Q And are you familiar with the work that Mr. Katz has done in
23 connection with this proposed conversion proceeding?

24 A Actually you've stimulated my memory.. yes.

25 Q And are you now recalling that Mr. Katz has been proffered as

1 an expert witness on behalf of the WSMA?

2 A I believe that is the case, but I'm not entirely sure.

3 Q Did you understand that Mr. Katz and his team were preparing
4 a report for submission to the OIC, the Commissioner, in
5 connection with this proceeding?

6 A I'm not entirely sure on that.

7 Q You're not - you're not sure whether Mr. Katz and others
8 working with him were working on a report of the proposed
9 Premera conversion for submission in this proceeding?

10 MR. COOPERSMITH: Objection. I think that's been
11 asked and answered.

12 JUDGE FINKLE: Sustained.

13 Q (BY MS. EMERSON) Well, it's true, is it not, Mr. Perna, that
14 you, yourself, personally provided information to Mr. Katz
15 and others on his team in connection with their report?
16 Isn't that right?

17 A Directly to Mr. Katz? I . . . I'm not recalling that
18 actually.

19 Q Do you recall providing input to one of his colleagues,
20 Mr. Mark Gardner?

21 A I've been in communication with both Mr. Katz and Mr. Gardner
22 in the context of the medical practice data project as the
23 University of Washington was one of the participants in that.
24 But I'm not recalling it in the context of the Premera
25 conversion.

1 MS. EMERSON: May I approach, your Honor?

2 JUDGE FINKLE: Yes.

3 Q (BY MS. EMERSON) Now, Mr. Perna, I've handed you an e-mail
4 dated October 23, 2003 from you to Mark Gardner, Aaron Katz,
5 Patricia Lichiello. Is that correct?

6 A That's correct.

7 Q Now, does this e-mail refresh your recollection with respect
8 to input that you provided to Mr. Gardner, Mr. Katz and
9 others involved on Mr. Katz's team in connection with an
10 expert report?

11 A Yes, actually it does. Thank you.

12 Q Now, if I can ask you to turn to the first e-mail. There are
13 two e-mails here. There's a message from Mark Gardner. And
14 that appears on the bottom of what is what is page 132. Do
15 you see that?

16 A Yes, I do.

17 Q And it appears that on October 17, 2003, Mr. Gardner was
18 writing to a number of folks connected with the Intervenors
19 concerning a Powerpoint presentation that summarizes some of
20 the main findings thus far that will go into a paper number
21 two on Premera's involvement in health insurance markets in
22 Washington and Alaska. Do you see that?

23 A Yes, I do.

24 Q And it appears that Mr. Gardner was looking for comments and
25 feedback to his proposed findings; is that correct?

1 A That is correct.

2 MR. COOPERSMITH: Your Honor, all of this is
3 really beyond the scope of the direct. And counsel can
4 direct these questions to Mr. Katz if she likes.

5 JUDGE FINKLE: Overruled.

6 Q (BY MS. EMERSON) Now, on October 23rd, in your e-mail to
7 Mr. Gardner and Mr. Katz, you did, in fact, respond with some
8 of your comments to the proposed findings that were going
9 into their report number two; is that correct?

10 A That is correct.

11 Q And it appears on this first page, which is page 131, that
12 you provided some comments about some niggling details. Did
13 I read that correctly?

14 A Essentially just some formatting issues which I think
15 actually is helping me understand now why I did not recall it
16 in that context. Apparently I did give this a fairly cursory
17 review, from what I can determine from this, and gave some
18 guidance on formatting issues about Roman Numerals and that
19 sort of thing.

20 Q Do you recall providing some substantive comments as well?

21 A Again, not off the top of my head.

22 Q Okay. Well, let's turn to the second page.

23 A Okay.

24 Q Now, if I look down into what I'll refer to as the third
25 paragraph, your e-mail states that you, quote, "go on to more

1 substantive issues;" is that right?

2 A Yes, I do.

3 Q And it appears that the first substantive issue that you
4 address is that you're asking Mr. Katz, Mr. Gardner, his
5 colleague Ms. Lichiello, to consider including some
6 information on the health plans administrative services only
7 lines of business; is that right?

8 A Mm-hmm. That is correct.

9 Q And so you want to make sure that OIC market share data
10 doesn't misstate the reality of insurance coverage because it
11 frequently does not include all of the self-insured data; is
12 that right?

13 A Yes.

14 Q And it seems like after you provide information about where
15 to look for market share information, you go on to talk to
16 Mr. Katz, Mr. Gardner, about tax issues that you believe they
17 should consider; is that correct?

18 A I'm sorry. Where is that?

19 Q Tax issues.

20 A Oh, I see it here. Yes.

21 Q Now, you're not an expert on tax matters, are you?

22 A No, I'm not.

23 Q But you thought it would be helpful to provide Mr. Gardner
24 and Mr. Katz with information about Premera's tax situation
25 over the last few years?

1 A Not at all. I was passing along my perspective on this issue
2 at the time, whether or not it would be helpful or not.

3 Q And it looks like in the second to the last paragraph, you
4 told Mr. Katz, Mr. Gardner, "I think it's an important issue
5 that should be addressed somewhere." Isn't that right?

6 A I'm sorry. Where are you?

7 Q This is your second to the last paragraph, just above your --

8 A I see it now. Yes.

9 Q Right. Above the paragraph that reads, "Hope these remarks
10 are of some value." Correct?

11 A Yes. That is correct.

12 Q Now, if you look at the top of this page, there is a
13 reference to your having trouble reconciling the slide on the
14 1999 CEO compensation with the slide on compensation for the,
15 quote, "top nine executives." Is that right?

16 A Yes.

17 Q And your e-mail goes on, "That slide" - by this you're
18 referring to the second slide - "is an average so I'm seeing
19 an averaging of Gubby Barlow's compensation moderated by his
20 next two highest-paid henchmen - I mean senior staff."

21 A That's correct.

22 Q Are those your words, Mr. Perna?

23 A Yes, they are.

24 Q And those are the words that you provided to Mr. Gardner,
25 Mr. Katz, who were preparing a report to be submitted to the

1 Insurance Commissioner?

2 A Said in jest, yes.

3 Q Mr. Perna, did you understand that Mr. Katz and his team were
4 preparing an independent objective report on the proposed
5 conversion or an advocacy piece on behalf of their clients?

6 A As best as I could determine, it would be an independent
7 assessment.

8 Q With some input from you; is that correct?

9 A Yes, since they had sought some questions from me. Yes.

10 Q Mr. Perna, now, you stated that . . . Strike that. Do you
11 you, yourself, do advocacy work on behalf of the WSMA?

12 A Yes, I do.

13 Q Are you a registered lobbyist?

14 A Yes, I am.

15 MS. EMERSON: May I approach, your Honor?

16 JUDGE FINKLE: Yes.

17 MS. EMERSON: Before we move on, I would like to
18 offer Exhibit P-208, which is Mr. Perna's e-mail.

19 MR. COOPERSMITH: No objection.

20 JUDGE FINKLE: Admitted.

21 Q (BY MS. EMERSON) Mr. Perna, could you please tell me is
22 Exhibit 207 that I've handed you an e-mail that you wrote to
23 Jennifer Hanscom on November 20, 2003?

24 A It appears to be.

25 Q And it's responding to an e-mail from Tom and Deedle; is that

1 correct?

2 A That is correct.

3 Q Would that be Tom Curry, the Executive Director of the WSMA?

4 A That is correct.

5 MS. EMERSON: At this time, we would move to admit
6 Exhibit P-207.

7 MR. COOPERSMITH: No objection.

8 JUDGE FINKLE: Admitted.

9 Q (BY MS. EMERSON) Mr. Perna, please look at Exhibit P-209.

10 A 209?

11 Q 209. It should be --

12 A Oh, thank you.

13 Q Is Exhibit 209 an e-mail that you wrote to Jan Monaco on
14 November 12th, 2003?

15 A It appears to be.

16 Q And below that e-mail that you wrote to Ms. Monaco, there
17 appears to be an exchange between Ms. Monaco and yourself; is
18 that correct?

19 A It appears to be, yes.

20 MS. EMERSON: We would offer Exhibit P-209.

21 MR. COOPERSMITH: No objection.

22 MS. deLEON: No objection.

23 JUDGE FINKLE: Admitted.

24 Q (BY MS. EMERSON) If you could please look at Exhibit P-210,
25 the last e-mail.

1 A Okay. I have it.

2 Q This appears to be an e-mail from Ms. Hanscom to Mr. Curry
3 and to you dated November 4th, 2003; is that correct?

4 A It appears to be.

5 Q And you are responding to an e-mail from Mr. Kyle Tanner; is
6 that correct?

7 A Yes.

8 Q Is that Mr. Tanner of the Premera Watch Coalition?

9 A Yes.

10 MS. EMERSON: At this time we would offer Exhibit
11 P-210.

12 MR. COOPERSMITH: No objection.

13 MS. deLEON: No objection.

14 JUDGE FINKLE: Admitted.

15 MS. EMERSON: Thank you, Mr. Perna. No further
16 questions.

17

18 REDIRECT EXAMINATION

19

20 BY MR. COOPERSMITH:

21 Q Mr. Perna, the Premera lawyer asked you about the medical
22 practice data project.

23 A Correct.

24 Q And she noted that the project studied all healthcare plans,
25 not just Premera; is that correct?

1 A That is correct.

2 Q And in your experience, how do physicians rate Premera
3 compared to other health insurance plans in this state, as
4 among the best plans to work with or among the worst?

5 MS. EMERSON: Objection. Lack of foundation.

6 JUDGE FINKLE: Just translate it to his direct
7 experience and receiving comments.

8 MR. COOPERSMITH: Yes, your Honor. I did, in
9 fact, phrase it that way.

10 Q (BY MR. COOPERSMITH) In your experience, have physicians
11 found Premera to be among the worst or among the best health
12 insurers in the state to work with?

13 A The feedback that I've received from physicians and practice
14 managers have graded it as one of the worst.

15 Q And have they rated specifically - that feedback, does that
16 specifically express or characterize Premera as among the
17 worst for administrative barriers to care?

18 A Yes.

19 Q And does that feedback specifically rank Premera as among the
20 worst on reimbursement?

21 MS. EMERSON: Objection. Leading.

22 JUDGE FINKLE: Rephrase.

23 Q (BY MR. COOPERSMITH) How is - how do the physicians rank
24 Premera compared to other health insurers in the state on
25 reimbursement?

1 A The feedback I've received from physicians and practice
2 managers is that they are one of the lower payers.

3 Q And how do physicians who have spoken to you rank Premera
4 compared to other healthcare providers in the state on
5 contract negotiating practices?

6 A Similarly, they rank it as one of the more difficult plans to
7 work with.

8 Q And could you return to the revised direct testimony that you
9 filed in this case. And the Premera lawyer had you read or
10 rather refer to paragraph 28 of your testimony. I'd like for
11 you to read paragraph 28 into the record, please.

12 A Okay. "For example, Premera identifies CIGNA as a strong
13 competitor, yet CIGNA covered less than one percent of the
14 state's insured population in 2002."

15 Q Do you stand by that statement?

16 A Yes, I do.

17 Q And she also directed your attention to paragraph 29. Would
18 you read that into the record.

19 A Yes. "Aetna is another carrier that Premera alleges is a
20 formidable competitor, yet in 2002, Aetna had a mere
21 1.28 percent of the market regulated by the Office of the
22 Insurance Commissioner."

23 Q And do you stand by that statement?

24 A Yes, I do.

25 Q And she also had you look at paragraph 32. Could you turn to

1 that paragraph and read that into the record.

2 A "Premera even exaggerates the competitive climate by claiming
3 it must compete with companies that are not actually
4 insurers, such as FirstChoice Health Network, PHCO and
5 NorthwestOne, all of which are PPO's."

6 Q Mr. Perna, is it your understanding that FirstChoice Health
7 Network is a PPO, a preferred provider, a rental network of
8 physicians?

9 A That is my understanding.

10 Q And is it your understanding that PHCO is also a PPO or
11 rental network of physicians?

12 A That is my understanding.

13 Q And is that your same understanding with NorthwestOne?

14 A Yes.

15 Q Turning now to the subject of claims payments that Premera
16 attorney asked about whether you had personal knowledge, and
17 you stated you did not have personal knowledge. Is that
18 correct?

19 A I'm sorry. What was --

20 Q Personal knowledge of the claims payment practices of the -
21 of Premera; is that correct?

22 A In the sense that I do not submit claims myself.

23 Q Correct. Okay. And what then is the source of your
24 knowledge about how physicians' claims get handled and paid
25 by Premera?

1 A What is reported to me by physicians and practice
2 administrators.

3 Q And are those reports from physicians and practice
4 administrators, are those few in number, or have they been
5 extensive over the years?

6 A Over the years, they've been very extensive.

7 Q And in your experience, have those reports been reliable in
8 the past or unreliable?

9 A I have found them to be --

10 MS. EMERSON: Objection. Foundation.

11 JUDGE FINKLE: Could you lay a foundation?

12 Q (BY MR. COOPERSMITH) You have relied upon information from
13 physicians and practice administrators in the past regarding
14 claims payments; is that correct?

15 A Yes.

16 MS. EMERSON: Objection. Leading.

17 JUDGE FINKLE: Well, overruled. That's
18 preliminary. Go ahead.

19 Q (BY MR. COOPERSMITH) And have you used that information in
20 your work as the director of healthcare economics for the
21 WSMA?

22 A Yes, I have.

23 Q And have you found that information to be information that
24 you could rely upon?

25 A Yes, I have.

1 Q Okay. And you also were asked about government reimbursement
2 and malpractice; is that correct?

3 A That is correct.

4 Q And does the WSMA believe that both of those issues
5 exacerbate the problems in the healthcare market?

6 A Yes.

7 MS. EMERSON: Objection. Leading.

8 JUDGE FINKLE: Sustained.

9 Q (BY MR. COOPERSMITH) What is WSMA's position on government
10 reimbursement and the malpractice coverage situation in the
11 state?

12 A WSMA has stated that government payment - reimbursement rates
13 within government programs such as Medicare and Medicaid are
14 far below the cost of providing care. And I'm sorry. The
15 second part was?

16 Q The malpractice coverage.

17 A Thank you. That there is, indeed, a professional liability
18 crisis in this state.

19 Q And how do those two situations influence, if at all, the
20 WSMA's position on Premera's proposed conversion?

21 A The issue being that if the conversion were to be approved
22 would further exacerbate the pressures on medical practices.

23 Q All right. And finally, you were asked about the care
24 facilitation program. And the Premera lawyer asked you about
25 testimony from a Premera executive about certain promises

1 about how the care facilitation program will turn out; is
2 that correct?

3 A That's correct.

4 MS. EMERSON: Objection. Mischaracterizes the
5 question and the testimony that's come in on the issue.

6 JUDGE FINKLE: Rephrase.

7 Q (BY MR. COOPERSMITH) You were asked about whether you heard
8 testimony from a Premera executive making certain
9 representations about what the care facilitation program
10 would do for physicians and for patients; is that correct?

11 A That is correct.

12 Q And has Premera made promises to physicians and patients in
13 the past?

14 A Certainly.

15 Q And has it been your experience that Premera has delivered on
16 the promises it's made to - all the promises it's made to
17 physicians and patients in the past?

18 A Based on what I hear from physicians and practice
19 administrators, there is a concern that the promises of
20 improvements within programs have not necessarily come to
21 fruition.

22 MR. COOPERSMITH: No further questions of this
23 witness at this time.

24 MS. deLEON: No questions.

25 MS. EMERSON: No further questions.

1 JUDGE FINKLE: Thank you. Please step down.
2 What's your pleasure?

3 MR. KELLY: Well, we have a couple of procedural
4 issues we'd like to address before the end of the day.

5 JUDGE FINKLE: What I want to be pretty sure of is
6 that we'll conclude on Monday with the OIC's final position
7 statement. Are we in good shape for that?

8 MR. MADDEN: If I can have, on our end - because I
9 think we're running into --

10 JUDGE FINKLE: Yeah. You need to . . .

11 MR. MADDEN: I'm running . . . You know, my
12 reflexes, seeing you, are to stand up. And if I can just
13 consult with Ms. Hamburger for a minute. I think we're into
14 our case. But I think that the - any reasonable projection,
15 certainly we're done fairly quickly with our direct testimony
16 on Monday. And it's the cross-examination that will drive
17 it. So let me just check with her.

18 Trying to add this up. It appears to us reasonable to
19 say we would be able to complete our direct easily within the
20 time allotted in the morning. And, you know, it's going to
21 be driven by the cross-examination. So the witnesses
22 remaining are - help me here, but Mr. Greenawalt, Mr. Larsen,
23 Mr. Katz, Mr. Benbow, Mr. Cantrell and Mr. Dauner.
24 Mr. Greenawalt and Mr. Dauner will be on the order of 10 to
25 15 minutes. Mr. Larsen, perhaps half an hour.

1 MS. HAMBURGER: Mr. Katz half an hour.
2 Mr. Cantrell probably 10, 15 minutes. And Mr. Benbow 20 to
3 30 minutes.

4 JUDGE FINKLE: What's your guess?

5 MR. KELLY: I think we would probably get it done
6 Monday afternoon with time to spare for Mr. Odiorne.

7 MS. HAMBURGER: Your Honor, the Alaskan folks.

8 MS. McCULLOUGH: If we do bring witnesses, they
9 wouldn't take any more than 10 to 15 minutes each.

10 JUDGE FINKLE: And --

11 MS. McCULLOUGH: And there are only two.

12 JUDGE FINKLE: Two at most?

13 MS. McCULLOUGH: Yeah.

14 JUDGE FINKLE: What do you think in terms of cross
15 of the witnesses who were identified and also how long you'd
16 expect Mr. Odiorne to be testifying?

17 MR. HAMJE: Well, I certainly think with respect
18 to Mr. Odiorne, we'd keep within the 30 minutes. So that's
19 number one. I can't - at this point in time, I don't know
20 what it will be if it's less than that. But in terms of
21 cross-examination of the witnesses, Intervenors' witnesses,
22 it will be minimal on our part.

23 JUDGE FINKLE: Let me suggest that personally, I'd
24 just as soon wrap it up as soon as we get through the
25 procedural matters and leave it that we'll run late if

1 necessary to complete Mr. Odiorne's testimony on Monday.
2 Hopefully we won't need to do that. But I think you should
3 bear in mind that we may crunch it through on Monday to
4 accomplish that goal. Does that sound reasonable to
5 everyone?

6 MR. HAMJE: That's fair, your Honor.

7 MR. MITCHELL: We have the weekend to prepare.

8 JUDGE FINKLE: Okay. Let's turn to the
9 procedures.

10 MR. KELLY: Two quick procedurals. They're really
11 kind of related. I think it would be good if they can be
12 resolved today. One is what to do with pre-filed testimony
13 if witnesses - if the Intervenor witnesses are not called, as
14 it sounds like a number of them may not be. And our
15 suggestion would be that the testimony simply be treated as
16 unsworn submissions, like any other letter or whatever sent
17 to the Commissioner. The reason we're asking it be unsworn
18 is otherwise we'd be denied cross-examination opportunity.
19 And I think sworn testimony might well be otherwise
20 considered to be given greater weight. So that's our
21 suggestion on that. And I think it would be useful for
22 everyone if we could resolve it today, for planning purposes
23 and so forth.

24 MS. HAMBURGER: We have no objection to that.

25 MR. HAMJE: Makes it real easy.

1 JUDGE FINKLE: Bracing myself here.

2 MR. KELLY: We'll be on a run here. The other one
3 is . . . I'm left speechless. The other is timing of
4 disclosure of rebuttal witnesses. And this may seem a little
5 theoretical because I think we're just saying we'd hope we
6 can get through Mr. Odiorne on Monday. But if, for some
7 reason, things go faster, then we would come up to what, if
8 any, rebuttal witnesses might be called on - by either party.
9 And I know that Mr. Coopersmith indicated he might have a
10 rebuttal witness. He was asking me, "Well, if you have one,
11 what will you do?"

12 I said, "We haven't made up our minds yet."

13 We both then noted, well, there is maybe this
14 disclosure requirement from your order if - for a witness
15 that comes on Monday, you have to notify by Friday; Tuesday,
16 you would have to notify by Sunday evening.

17 And my initial discussion with Jeff was, well, if that
18 would apply, one of the benefits or perils of practicing in
19 partnership is that other people sometimes think of
20 additional things and the observation was that it's
21 conceivable that on Monday during the day, something might
22 come up on anybody's part where you would want a rebuttal
23 witness.

24 So the first question I guess is: Did the Special
25 Master intend that this disclosure requirement be applicable

1 to rebuttal witnesses as well? And then if so, how should we
2 handle this?

3 Our inclination is to just say since there wasn't this
4 problem of practically something coming up on Monday, let's
5 just go with everybody agreeing no disclosure. But first we
6 need to have a ruling from the Special Master as to whether
7 the ruling intended to go to rebuttal.

8 JUDGE FINKLE: Let me get others' positions.

9 MR. HAMJE: Well, first of all I want to make sure
10 I understand what Mr. Kelly is suggesting. If there are
11 going to be rebuttal witnesses, my experience is - has always
12 been that the evidence is closed after the rebuttal witnesses
13 have been completed. And so at that point in time, that's
14 when Mr. Odiorne would have his opportunity to take the
15 stand.

16 Is that - is that correct? Is that your understanding?

17 JUDGE FINKLE: No. The . . . I'm expecting
18 Mr. Odiorne to testify at the conclusion of the Intervenor's
19 case.

20 MR. HAMJE: Okay. So then I misunderstood your
21 ruling.

22 JUDGE FINKLE: And this is - other things - I
23 don't mean to anticipate what may . . . If others agree to
24 the contrary, I'll listen.

25 MR. COOPERSMITH: Well, your Honor, at the risk of

1 being efficient and amicable here, the Intervenor has no
2 objection to disclosing the rebuttal witnesses right now.
3 The WSMA is the only Intervenor that anticipates calling one.
4 If we do, we expect that testimony to be under 15 minutes.
5 And we can proceed late Monday or Tuesday, whatever suits the
6 parties.

7 And of course, we, too, believe that Mr. Odiorne should
8 be able to go forward first and then have the rebuttal
9 testimony presented.

10 JUDGE FINKLE: I'm not sure if there's agreement
11 or not. Here's what strikes me as making sense. You know,
12 you will be able to listen to all of the evidence and
13 disclose by the close of Monday any rebuttal testimony. And
14 that would occur Tuesday, after Mr. Odiorne's been examined
15 by other parties and OIC Staff. I think that strikes a
16 balance.

17 I don't know that I really thought of what would apply
18 to rebuttal testimony. But obviously you can't anticipate
19 what may occur on Monday that might require you to call a
20 rebuttal witness.

21 MR. COOPERSMITH: And just ask a simple scheduling
22 matter, your Honor. Then the rebuttal witness would not have
23 to be available Monday even if we somehow moved through all
24 of the witnesses; that they can be informed today that they
25 won't be called until Tuesday; is that correct?

1 JUDGE FINKLE: The ideal schedule here is
2 Mr. Odiorne testifies at 11:00 Monday morning and then we
3 recess until Tuesday. But in any event, once he's taken the
4 stand, we'll recess. So rebuttal would follow his
5 cross-examination no earlier than 10:00 Tuesday morning
6 presumably. Any other procedural issues?

7 MR. HAMJE: Should we --

8 MR. MITCHELL: Some exhibit issues.

9 MR. HAMJE: We could talk about some exhibits.
10 But I also wanted to ask about closing. Is that something
11 that we could also conclude on Tuesday? Is there going to be
12 some time set aside for some closing statements?

13 JUDGE FINKLE: Well, sure. I hope so. Let me ask
14 you how long you would like and how long others would like
15 for closing.

16 MR. HAMJE: We were thinking of an hour for us for
17 closing statement.

18 JUDGE FINKLE: How about Premera and Intervenor?

19 MR. MITCHELL: Well, I'm awaiting the verdict from
20 the chess clock.

21 JUDGE FINKLE: If you had your druthers.

22 MR. MITCHELL: If I had my druthers, I'd say half
23 an hour, maybe 45 minutes.

24 JUDGE FINKLE: Each of the Intervenor, I assume,
25 may wish to make a closing. Fair to say?

1 MR. COOPERSMITH: Yes.

2 MS. HAMBURGER: Time permitted.

3 JUDGE FINKLE: Give it to me separately or
4 cumulatively. What are you looking at?

5 MR. COOPERSMITH: We, too, would need to see what
6 the remaining time is. On the WSMA's behalf, I would think
7 it would be fewer than 15 minutes.

8 JUDGE FINKLE: About that for each of you perhaps?

9 MR. MADDEN: I think so.

10 JUDGE FINKLE: Cumulative hour or less? And are
11 you assuming - we might as well get clear on this - that
12 there would be a single closing for each party?

13 MR. MITCHELL: I'm not sure I'm following.

14 JUDGE FINKLE: I've heard of rebuttal closings.
15 And I wasn't assuming that but - considering this proceeding,
16 that there necessarily would be. But I thought you ought to
17 all be on the same page with that expectation.

18 MR. HAMJE: With respect to the OIC Staff, that's
19 certainly what we contemplated ourselves, for the OIC Staff.
20 With respect to Premera and the Intervenors, I can't speak
21 for them.

22 MR. MITCHELL: On behalf of Premera, that would be
23 fine. Chess clock may drive that one, too. One question I
24 guess that's worth asking at this juncture is whether it is
25 contemplated that there will be an opportunity for the

1 Commissioner, should he so desire, to ask questions of
2 whoever is doing closing, if that's something that the
3 Commissioner would be interested in and might be a useful
4 exercise in terms of being able to shape the argument to the
5 concerns that he has.

6 JUDGE FINKLE: I think, you know, I would assume
7 that he will feel and should feel free to ask questions
8 during closing. But perhaps you will give your closing
9 subject to that questioning.

10 MR. KREIDLER: I think that's fair to assume. At
11 this point, it's been much like the questions. It depends a
12 lot on what is said. And if there are some questions that I
13 still have in my mind afterwards, there's no guarantee that
14 I'd ask any.

15 JUDGE FINKLE: Yeah. I mean helpful I think to
16 pull the threads of the long proceeding together from each of
17 your perspectives and not to wait and see what the
18 Commissioner has in mind to ask. You know. I think it's
19 useful to kind of draw a circle around your view of the case.
20 And then I'm sure based on experience, there'll be a couple
21 questions for each of you. Anything else that we should talk
22 about this afternoon?

23 MR. HAMJE: Yes. I think there are some exhibit
24 issues still.

25 MR. TAUSEND: You'll recall, your Honor, that

1 Mr. Mitchell offered Premera 30, 31, 33 and 34, which were in
2 connection with Dr. McCarthy's testimony. At that time,
3 Mr. Hamje had said he would leave that issue to Mr. Ellis.
4 Mr. Ellis and I have talked. And the OIC has no objections.

5 MR. HAMJE: We have no objections to those
6 exhibits being admitted.

7 JUDGE FINKLE: Repeat the numbers just so that
8 they can.

9 MR. TAUSEND: Premera 30, 31, 33, 34. 32 has
10 already been admitted.

11 JUDGE FINKLE: Admitted.

12 MR. TAUSEND: And on the issue of the substitution
13 of the full text of Carlton and Berloff (phonetic),
14 Ms. Nelson has it, and that will be substituted tomorrow.
15 There's just some technical details to work out.

16 JUDGE FINKLE: I think we'll just see Legionnaires
17 tomorrow. But we'll do it Monday.

18 MR. MITCHELL: One other matter, your Honor. The
19 technical memorandum supporting the Ernst & Young opinion,
20 which was discussed briefly during Mr. Ashley's examination,
21 I believe we have not offered - I'm not actually expecting
22 anybody really to want to read it, but so the record is
23 complete, I would suggest that that be made Exhibit P-220.

24 MR. HAMJE: We have no objection to that.

25 MR. MADDEN: No objection.

1 JUDGE FINKLE: Admitted. P-220.

2 MR. MITCHELL: Thank you so much.

3 JUDGE FINKLE: Anything else? Monday at 9:00.

4 (Hearing concluded.)

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